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No. _____

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1994

THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE,

*Petitioner,*

—v.—

FREEHOLD COGENERATION ASSOCIATES, L.P., *et al.*,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

These questions involve the interpretation of the Public Utility Regulatory Policy Act of 1978 ("PURPA") (Pub. L. 95-617, 92 Stat. 461), rules prescribed thereunder by the Federal Energy Regulatory Commission ("FERC") (18 C.F.R. § 290.101, *et seq.*), and the implementation of those rules by the New Jersey Board of Public Utilities ("Board").* The FERC rules govern, *inter alia*, long-term purchases of electricity by public utilities at a price fixed at the beginning of the term ("power purchase agreement") from certain cogeneration projects, called qualifying facilities ("QFs," See 16 U.S.C. § 796(16)(C)). The FERC rules set the purchase price at the avoided cost (16 U.S.C. § 824a-3(d)), which is the cost to the utility of alternative sources of electricity calculated at the time that the purchase agreement becomes legally binding and enforceable (hereafter referred to as "the relevant PURPA/FERC purchase price" or "the relevant PURPA/FERC ceiling" or "the relevant current avoided cost"). The relevant PURPA/FERC ceiling protects the utility's ratepayers from subsidizing cogeneration, when a cheaper alternative source of electricity is available. With this terminology, the questions presented for review are:

1. Are the utility's ratepayers entitled, under PURPA, to have the state regulatory commission exclude from rates a power purchase agreement set at a price exceeding the relevant PURPA/FERC ceiling?

2. Is the federal judiciary prohibited, under PURPA, from exercising jurisdiction over a state regulatory commission proceeding, the purpose of which is to exclude from rates the cost of a power purchase agreement set at a price exceeding the relevant PURPA/FERC ceiling?

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* During the period relevant to this case, the state legislature changed the Board's name from the Board of Public Utilities to the Board of Regulatory Commissioners in 1990, and back again to the Board of Public Utilities in 1994.

## PARTIES TO THE PROCEEDING

The names of all parties to the proceeding in the U.S. Court of Appeals for the Third Circuit ("Third Circuit") appear in the caption of the decision of the Third Circuit except for the New Jersey Division of the Ratepayer Advocate, which was an intervenor in the proceedings before the District Court and an appellee in the proceedings before the Third Circuit.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## PETITION FOR WRIT OF CERTIORARI

Petitioner, The New Jersey Division of the Ratepayer Advocate ("The Ratepayer Advocate")[1], respectfully requests that the Court issue a writ of certiorari to review the judgment of the the Third Circuit entered on January 9, 1995.

## OPINIONS BELOW

The Ratepayer Advocate hereby adopts the appendix, and pagination (A-1, *et seq.*) of the Petition for Writ of Certiorari

[1] This designation includes the predecessor agency, the Division of Rate Counsel.

of Jersey Central Power and Light Company ("JCP&L") in connection with the same judgment of the Third Circuit.

The opinion of the United States District Court for the District of New Jersey ("the District Court") is not reported. (A-30). The opinion of the Third Circuit, issued January 9, 1995, is reported at 44 F.3d 1141. (A-1). The order of the Third Circuit, entered March 7, 1995, denying a petition for rehearing and suggestion for rehearing in banc, is not reported. (A-29).

## JURISDICTION

The judgment of the Third Circuit sought to be reviewed was entered January 9, 1995.

The Third Circuit denied a timely petition for rehearing and suggestion for rehearing in banc, filed January 23, 1995, by an order entered March 7, 1995.

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

## STATUTES AND REGULATIONS INVOLVED

16 U.S.C. §§ 824-3(a), (b), (d), (e), (f), and (g); respectively, PURPA, §§ 210(a), (b), (d), (e), (f), and g. (See A-39 to A-48).

FERC Regulations, 18 C.F.R. §§ 292.301(b), 292.303(a), 292.304(a) and (d), 292.602(c). (See A-48 and A-49, except for the first and second citation).

18 C.F.R. § 292.301(b) provides

> *Negotiated rates or terms.* Nothing in this subpart:
>
> (1) Limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

18 C.F.R. § 292.302(a) provides

*Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with § 292.304, any energy and capacity which is made available from a qualifying facility:

(1) Directly to the electric utility; or

(2) Indirectly to the electric utility in accordance with paragraph (d) of this section.

## STATEMENT OF CASE

Under the Interstate Commerce Clause of the Constitution of the United States, the United States Congress adopted PURPA for, among other reasons, the encouragement of cogeneration. That encouragement was not without limitation—PURPA incorporated a protection for ratepayers against having to *subsidize* the development of cogeneration. (See the discussion of the first point of the reasons for granting the writ, *infra*). According to PURPA, utilities are to purchase electricity from QFs under rules prescribed by FERC. However, Congress specifically prohibited offers to purchase electricity from QFs at a purchase price exceeding the relevant PURPA/FERC purchase price, which equalled the relevant current avoided cost to the utility of alternative electricity. (16 U.S.C. § 824a-3(b)).

The appeal before the Third Circuit concerned a power purchase contract between Freehold Cogeneration Associates, L.P. ("Freehold") and JCP&L. According to the uncontroverted evidence in the record of the Third Circuit Court, the Board required a purchase price for the electricity supplied by Freehold at a level prohibited by Congress under PURPA, *viz.*, a level above the avoided cost to the utility of alternative

electricity sources at the time the power purchase agreement became effective. Because the Board required a purchase price in excess of the avoided cost to the utility, the power purchase agreement is void pursuant to PURPA which was enacted by Congress exercizing its powers under the Interstate Commerce Clause.

Furthermore, any purported administrative approval of such an agreement, by FERC or the Board, is contrary to the express language of PURPA, which is the statute from which each agency derives its powers in this field. Thus, such an "approval" is null as *ultra vires*.

In addition, by its own terms, ¶ 20.1, the agreement was not to become effective and binding upon the parties until, *inter alia*, the Board had entered a final order approving: (1) the agreement as executed by the parties; and (2) the recovery in rates of all costs to be paid Freehold under the agreement. (Joint Appellate Appendix, ("J.A."), 98). Under New Jersey law, which *according to the terms of the agreement itself*, ¶ 28.1 of the Agreement (J.A. 104), governs the agreement, the Board's *ultra vires* order of approval was void. Moreover, a contract conditioned upon an *ultra vires* approval of the price term is void *ab initio*. (See citations contained in the discussion of the first point under the reasons for granting the writ, *infra*).

The questions presented for review raise two general issues. The first general issue deals with what constitutes state implementation of the FERC rules on the pricing and purchase of QF electricity. The second related general issue has to do with the limits on the federal judiciary to review the state's efforts to implement those FERC rules. The resolution of these issues will allocate the respective responsibilities between the state and federal governments and will determine how the forthcoming increase in competition in the electrical power industry will play itself out. Will ratepayers be able to protect their rights at the state level?

By enacting PURPA Congress created a general scheme with roles for FERC and the pre-existing state regulatory institutions. FERC was required to adopt rules following the broad statutory guidelines specified in PURPA and the states were required to implement the FERC rules for each of the regulated utilities.

To simplify the statement of the case, the Ratepayer Advocate will adopt the statement of facts stated in the opinion of the Third Circuit (A-2 to A-5) with the change in emphasis and the modifications described below.

In 1989, the Board "grandfathered" the proposed Freehold cogeneration project, under an earlier regulation which implemented FERC rules. It ordered JCP&L and Freehold to negotiate a power purchase agreement, whereby JCP&L would purchase Freehold's electricity at a price set at JCP&L's 1989 avoided cost. The extensive negotiations between JCP&L and Freehold took three years to produce the agreement. The Board approved the agreement which was executed on March 26, 1992, at its agenda meeting of June 9, 1992. In the order approving the agreement (J.A. 116) the Board found that the agreement was consistent with the Board's earlier grandfathering order and that the agreement was "fair and reasonable." Also in the order, the Board found the rates specified in the agreement to be "reasonable" and "reasonably and prudently incurred" and undertook to allow JCP&L to recover the price and costs of the agreement through JCP&L's electric rates even though the purchase price exceeded JCP&L's current 1992 Board-approved avoided cost by a substantial amount—contrary to PURPA and the FERC rules on purchase price.

On January 5, 1994, after JCP&L at the request of the Board identified the Freehold project as one of the uneconomic projects which had not yet begun construction, the Board directed the parties to renegotiate the purchase price or, otherwise, negotiate an appropriate buy-out. The Board indicated that if the negotiations failed, it would be prepared to hold evidentiary hearings to review the possible actions it

could take. The negotiations indeed failed and JCP&L requested the evidentiary hearings. On February 17, 1994, the Ratepayer Advocate requested hearings to address the extent to which the costs associated with the power purchase agreement could legally be recovered from JCP&L's ratepayers. (J.A. 577). The Board granted the requests for hearings. The evidentiary hearings uncovered evidence, which was marked for identification by Freehold as Exhibit FCA-18 on May 11, 1994, (hereafter, "FCA-18") that the power purchase price had been set substantially higher than the relevant Board-approved PURPA/FERC ceiling.[2] The disparity amounted to $665 million over the 20-year life of the power purchase agreement. Ratepayers, in other words, were being asked to subsidize Freehold by paying $665 million more than the Board-approved PURPA/FERC ceiling over the life of the agreement.

Meanwhile, to foreclose further Board action in the proceeding, Freehold initiated the present action in the District Court for declaratory judgment on the ground that the Board was preempted by PURPA from holding hearings. After motion and cross motions for summary judgment, the District Court, considering only the question of jurisdiction, held that it did not have jurisdiction over the subject matter by virtue of, *inter alia*, PURPA § 210(g), 16 U.S.C. § 824a-3(g). This section prohibits the federal courts from exercising jurisdiction over the review of any state commission proceeding for the purpose of implementing requirements of FERC's rules on the purchase of QF-supplied electricity. The District Court did not address the parties' arguments which were based on doctrines of abstention or on the substantive law.

On appeal, the Third Circuit did not limit itself to the jurisdictional question addressed by the District Court, but rather, having found that the federal courts had jurisdiction, addressed the issues on the merits and overturned the decision

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[2] FCA-18 is at AA-8 and AA-9 of the Supplemental Appendix of the Ratepayer Advocate, dated September 6, 1994, in the record of the Third Circuit, below.

of the District Court. It held that, once the Board purported to approve the power purchase agreement, found it "just and reasonable" and consistent with avoided costs, the purchase had to be reflected in rates and the Board could not revisit those decisions. (See the discussion of the fourth point of the reasons for granting the writ, *infra*, where the opinion is quoted). The proceedings before the Board came to a halt. The Third Circuit, however, had refused to consider the jurisdictional argument presented by the Ratepayer Advocate on the ground that the argument was presented for the first time on appeal. This ground, in the view of the Ratepayer Advocate, is contrary to the decisions of the United States Supreme Court concerning raising the issue of subject-matter jurisdiction at any stage of appeal.

The Ratepayer Advocate's argument on jurisdiction was based on FCA-18, which had been uncontroverted in the Board proceeding, and which was made part of the record by the Third Circuit on motion of the Ratepayer Advocate without objection. FCA-18 was marked on May 11, 1994, for identification by Freehold in the Board proceedings, now halted by the Third Circuit, after briefs had been submitted to the District Court. Before this Board proceeding, the Ratepayer Advocate had not been aware of the existence of the document. JCP&L had provided FCA-18 to the Board Staff on June 1, 1992, just before the Board was to consider its approval of the contract at its agenda meeting of June 9, 1992. The document presented data that showed the amount by which the power purchase price in the agreement far exceeded the relevant Board-approved PURPA/FERC ceiling—by approximately $665 million over the life of the power purchase agreement. In the view of the Ratepayer Advocate, PURPA § 210(g)(1), 16 U.S.C. § 824a-3(g)(1), should have barred the Third Circuit from asserting jurisdiction, because the Board was in the midst of attempting to implement, pursuant to PURPA § 210(a), 16 U.S.C. § 824a-3(a), the FERC pricing rules prohibiting the power purchase of QF electricity at prices exceeding the PURPA/FERC ceiling.

## REASONS FOR GRANTING THE WRIT

### 1. Under PURPA, Ratepayers Have a Right to Have the State Regulatory Commission Implement the PURPA/FERC Prohibition Against the Subsidization of Cogenerators by Disallowance of Recovery of Long-Term Utility Purchases of QF Electricity at a Price Exceeding the Relevant PURPA/FERC Prescribed Level Applicable at the Time the Purchase Agreement Became Effective.

PURPA § 210(a), 16 U.S.C. § 824a-3(a), requires FERC to prescribe rules which require electric utilities to offer to purchase electric energy from QFs. PURPA § 210(b), 16 U.S.C. § 824a-3(b), states that the rules which FERC must prescribe for the purchase of electricity from qualifying cogeneration facilities by utilities:

> shall insure that . . . the rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators. . . .
>
> No such rule . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy. (Emphasis added)

(See, also, FERC's rules paralleling the statute (18 C.F.R. § 292.304(a)). The last sentence of this section of the statute precludes the prescription of a rule which allows any state regulatory commission to set the price of a purchase of QF-generated electricity exceeding the incremental cost. Thus, on the face of the statute the incremental cost ceiling for the purchase of QF-generated electricity is absolute. (FERC replaced the phrase, "incremental cost," of PURPA with the phrase, "avoided cost," in the rules it prescribed). PURPA does not

empower FERC or any implementing state regulatory commission with any discretion whatsoever to stray from this prohibition. Also, the pricing limitation does not require any individual or agency to take any action to have that prohibition enforced.

For long term contracts, such as the Freehold/JCP&L power purchase agreement, the pricing rule prescribed by FERC, 18 C.F.R. § 292.304(d)(2)(ii), requires that the price be based upon "the avoided costs calculated at the time the obligation is incurred." (Underlining added). This Court approved the FERC rules which set the purchase price at the statutory limit:

> At this early stage in the implementation of PURPA, it was reasonable for the Commission to prescribe the maximum rate authorized by Congress and thereby provide the maximum incentive for the development of cogeneration and small power production. (Underscoring added).

*American Paper Inst. v. Amer. Elec. Pow. Serv. Corp,* 461 U.S. 402, 417, 103 S.Ct. 1921, 1930, 76 L.Ed. 2d 22 (1983). This decision, being the second decision of this Court on PURPA and a decision which has guided state courts since 1983, has also given every potentially affected proposed QF notice that the highest purchase price at which a utility may be required to offer to purchase QF-electricity is at the avoided cost to the utility of alternative sources of electricity. Avoided cost is "the maximum rate authorized by Congress" because Congress explicity prohibited a price exceeding "avoided cost" in PURPA. (See PURPA § 210(b), 16 U.S.C. § 824a-3(b), quoted *supra.*). Since that time, due diligence for the financing of a proposed QF should have included a review of the legality of the purchase price *vis a vis* the PURPA/FERC price ceiling. Moreover, a utility should not be able to negotiate away the ratepayers' statutory right.

In *American Paper Inst., supra,* this Court explained the relationship between the "just and reasonable" requirement and the avoided cost limitation:

> Unless the "just and reasonable" language is to be regarded as mere surplusage, it must be interpreted to mandate consideration of rate savings for consumers that could be produced by setting the rate at a level *lower* than the statutory ceiling. (Underscoring and italics added).

*American Paper Inst.*, supra, footnote 9, U.S., at 415, S.Ct., at 1929. As the Court stated, a power purchase price cannot be "just and reasonable" with respect to consumers unless that purchase price is less than or equal to the PURPA/FERC current avoided cost. A state regulatory commission cannot, under the color of a finding that the purchase price exceeding avoided cost is "just and reasonable," include such a price in the rates charged the ratepayers. A finding that a power purchase price greater than the relevant PURPA/FERC price is "just and reasonable" is inconsistent with PURPA and thus *per se* unlawful. The action of a state regulatory commission approving such a purchase is void.

Furthermore, an important part of the Conference Report on PURPA reveals that the Congressional purpose for imposing the avoided cost ceiling in PURPA § 210(b) was for the benefit of ratepayers—to protect the ratepayers of the utility from having to subsidize cogenerators:

> . . . The provisions of this section are not intended to require the ratepayers of a utility to subsidize cogenerators or small power producers.

H.R. Conf. Rep. No. 95-1750, 98 (1978), U.S. Code Cong. & Admin. News 1978, 7659, at 7832. The Conference Report represents the final statement of terms agreed to by both Houses of Congress, and next to the statute itself, is the most persuasive evidence of congressional intent. Sutherland, *Statutory Construction*, § 48.08 (5th Edition). Any implementation of PURPA requiring a utility to offer to purchase QF electricity at a price greater than the PURPA/FERC ceiling is a subsidization of the cogenerator by the ratepayer because the ratepayer must pay more for cogeneration elec-

tricity than he would have had to pay if the utility had not been required to offer to purchase the QF electricity.

To summarize, PURPA requires, first, that the purchase price for QF electricity be just and reasonable to the consumer. Second, it forbids a price exceeding the relevant PURPA/FERC price. Third, these requirements are intended to benefit ratepayers. Therefore, the ratepayers are entitled to exclude from rates costs of any power purchase which is not just and reasonable and which exceeds the relevant PURPA/FERC price. This Court made clear the interdependence between "just and reasonable" and "avoided cost" in *Amer. Paper Inst., supra*; that the *maximum* allowable price is the full current avoided cost and that a "just and reasonable" price could not, by definition, be greater than the statutory limit under PURPA. Any purported approval by a state commission of a power purchase at a price greater than the relevant current avoided cost as just and reasonable is *per se* unlawful and void under PURPA. *A fortiori*, any purported approval of such a purchase as "just and reasonable" and as satisfying the avoided cost limitation, when in fact the purchase price exceeds the PURPA/FERC avoided cost limitation, is *per se* unlawful and void. Such an "approval" is not an implementation, but a *frustration* of the FERC rules governing the purchase price.

In parallel fashion, the application of the law of the State of New Jersey produces the same result; *viz.*, that Board "approval" of the power purchase agreement was *ultra vires* and void and the power purchase agreement was void *ab initio*. The agreement specifies that New Jersey law governs the contract. (J.A. 104). (This is permitted under the rules of FERC: 18 C.F.R. § 292.301(b)). See, *e.g.*, *Duff v. Trenton Beverage Co.*, 4 N.J. 595, 607, 73 A.2d 578 (1950), *Maguire v. Van Meter*, 121 N.J.L. 150, 152, 152 A.2d 445 (E.and A. 1938), and *Miske v. Habay*, 1 N.J. 368, 374, 63 A.2d 883 (1949).

This Court upheld PURPA as a valid exercise of the powers of Congress under the Commerce Clause of the United States

Constitution. *Federal Energy Regulatory Com'n v. Mississippi,* 456 U. S. 742, 759, 102 S.Ct. 2126, 2137, 72 L. Ed. 2d 532 (1982). Inherent in the Commerce Clause, the plenary exercise of these powers reaches and attaches *directly* to the contracts incorporating such a proscribed purchase—no matter that there may have been intervening state assent or approval—and these contracts are rendered void.

> . . . Contracts, however express, cannot fetter the constitutional authority of the Congress. Contracts may create rights of property, but when contracts deal with a subject-matter which lies within the control of the Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them. [Citations omitted].
>
> This principle has familiar illustration in the exercise of the power to regulate commerce. If shippers and carriers stipulate for specified rates, although the rates may be lawful when the contracts are made, if Congress through the Interstate Commerce Commission exercises its authority and prescribes different rates, the latter control and *override* inconsistent stipulations in contracts previously made. This is so, even if the contract be a charter granted by a state and limiting rates, or a contract between municipalities and carriers. [Citations omitted]. (Underscoring and italics added).

*Norman v. Baltimore & O. R. Co.,* 294 U.S. 240, 307 and 308, 55 S.Ct.407, 416 (1934).

In *FERC v. Mississippi, supra,* U.S. at 750, S.Ct. at 2132, this Court described the duties and obligations of the state regulatory commissions under PURPA § 210(f)(1), 16 U.S.C. § 824a-3(f)(1):

> In essence, then, the statute and the implementing regulations simply require the Mississippi authorities to adjudicate disputes arising under the statute. Dispute resolution of this kind is the very type of activity cus-

> tomarily engaged in by the Mississippi Public Service Commission.
>
> . . . . . .
>
> . . . The Mississippi Commission has jurisdiction to entertain claims analogous to those granted by PURPA, and it can satisfy § 210's requirement simply by opening its doors to claimants. That the Commission has administrative as well as judicial duties is of no significance. [Footnote omitted]. Any other conclusion would allow the States to disregard both the preeminent position held by federal law throughout the Nation [Citation omitted] and the congressional determination that the federal rights granted by PURPA can appropriately be enforced *through state adjudicatory machinery.* (Underscoring and italics added).

U.S., at 760 and 761, S.Ct. at 2137 and 2138.

The PURPA and FERC requirements to insure that the purchase price be "just and reasonable" and not to exceed the relevant PURPA/FERC ceiling are rules. (18 C.F.R. § 292.304(a)). The state regulatory commissions, in particular the Board, are obliged under PURPA § 210(f)(1), 16 U.S.C. § 824a-3(f)(1), to implement these rules. When a contract between a utility and a QF specifies a purchase price greater than the current avoided cost of the utility, the Board is under Congressional mandate to carry into effect the PURPA/FERC rules prohibiting such pricing *on behalf of ratepayers* as Congress intended. (See the Conference Report (quoted, *supra*) on Congressional intent).

**2. PURPA Prohibits the Courts of the United States from Exercising Jurisdiction over State Regulatory Commission Proceedings Initiated to Exclude from Rates Paid by Ratepayers the Recovery of a Long Term Purchase of QF Electricity at a Price Exceeding the Relevant PURPA/FERC Ceiling Applicable at the Time the Purchase Agreement Became Effective.**

Under PURPA § 210(f)(1), 16 U.S.C. § 824a-3(f)(1), each state regulatory commission must implement the rules prescribed by FERC under PURPA § 210(a), 16 U.S.C. § 824a-3(a). The FERC rules governing the utility's offer to purchase QF electricity, including the PURPA and FERC avoided cost ceiling on the purchase price, are such rules. PURPA § 210(e)(3)(A), 16 U.S.C. § 824a-3(e)(3)(A), prohibits exempting any QF from any state law or regulation in effect pursuant to PURPA § 210(f), 16 U.S.C. § 824a-3(f).

A critical provision for this case is PURPA § 210(g)(1) which prohibits any court of the United States from exercising jurisdiction over any action to review proceedings conducted by state regulatory commissions for the purpose of implementing any requirement of a rule under PURPA § 210(a), *i.e.*, implementation proceedings. PURPA § 210(g)(1) provides that judicial review of such state proceedings may be obtained in an appropriate state court pursuant to applicable state procedures. Thus, only a state court has jurisdiction over the review of an implementation proceeding.

The state regulatory commission proceedings under discussion give effect to FERC rules 18 C.F.R. § 292.303(a) and 18 C.F.R. § 292.304(d)(1). Rule 18 C.F.R. § 292.303(a) requires electric utilities to purchase electricity from QFs and rule 18 C.F.R. § 292.304(d)(1) sets the purchase price for long-term, fixed-price purchases as the avoided cost calculated at the time the obligation is incurred. The approval of a purchase price that exceeds the relevant PURPA/FERC price—the relevant current avoided costs at the time the obligation becomes enforceable—obviously *does not implement the rule*, but

rather *thwarts and contravenes it*. On the other hand, PURPA § 210(f)(1), 16 U.S.C. § 824(a)-3(f)(1), commands the state regulatory commission to implement the rule and thus to conform the purchase to these rules. Implementation under this section of PURPA requires notice and an opportunity for public hearing, *i.e.*, implementation requires a proceeding before the state regulatory commission. Thus, this kind of proceeding is merely an implementation proceeding, which triggers the section of PURPA that removes the jurisdiction of the courts of the United States.

The Third Circuit used FERC rule 18 C.F.R. § 202.602(c) to justify enjoining a state implementation proceeding. (A-6). Therefore, it is reasonable to give some consideration to this theory of federal court intervention. The regulation says in pertinent part:

> (1) Any [QF] shall be exempted . . . from State law or regulation respecting:
>
> (i) The rates of electric utilities; and
>
> (ii) The financial and organizational regulation of electric utilities.

It is inconceivable that Congress would have intended that this part of PURPA could be used to allow the federal judiciary to undermine the clear Congressional scheme of PURPA; that the FERC rules provide the substantive rules and that the state regulatory machinery, including the state court procedure for review, be the primary governmental means of carrying the substantive rules into effect and resolving disputes related to the implementation of the substantive rules. (See *FERC v. Mississippi, supra,* recognizing that the federal rights granted by PURPA can appropriately be enforced through state adjudicatory machinery). It is self-evident that, though Congress may have meant to preclude continuous scrutiny of rates of the sort to which utilities are subjected, it most certainly did not mean to preclude state regulatory commissions from implementing FERC rules prescribed pursuant to PURPA.

It was error for the Third Circuit to determine that a state proceeding with the purpose of conforming a power purchase to the relevant PURPA/FERC rules on the pricing of the purchase is preempted under 18 C.F.R. § 292.602(c)(1). This is entirely inconsistent with PURPA and undermines the grand design of Congress for PURPA. Suppose that any such aggrieved party to a state implementation proceeding could commence an action on the federal level on the ground that the manner of the state's implementation is utility-type regulation preempted by PURPA. (And, in fact, Freehold did exactly this when it determined that the Board matter, which it had initiated for approval of proposed changes to the power purchase agreement, was not proceeding as it had hoped). Then the federal court would assert jurisdiction, as the Third Circuit did, on the ground that preemption under 18 C.F.R. § 292.602(c)(1) is a PURPA right, distinct from implementation, with respect to which the federal court can assert jurisdiction, without the restraints on its jurisdiction over state implementation proceedings. That would tend to undermine the Congressional design to use "the state adjudicatory machinery" to implement, and review implementation of, FERC rules. See *FERC v. Mississippi*, *supra*.

**3. The Third Circuit Decision Exercised Jurisdiction over a State Regulatory Commission's Proceeding to Conform Recovery of a Power Purchase to the Statutory Limit Prescribed by Congress and FERC. This Is in Conflict with the Jurisdictional Prohibition of PURPA and This Court's Decision in *FERC v. Mississippi*. The Third Circuit's Decision Not to Consider the Ratepayer Advocate's Argument on Jurisdiction Is Also in Conflict with This Court's Decisions.**

Because PURPA § 210(g)(1), 16 U.S.C. § 824a-3(g)(1), forbids the federal courts from exercising jurisdiction over actions arising from a proceeding of a state regulatory commission implementing the rules prescribed by FERC under PURPA, a federal court's jurisdiction over Board proceedings depends upon whether the proceeding is one implementing

FERC rules. There is no avoiding that a federal court—to determine its jurisdiction—must preliminarily determine the nature of the Board proceedings to determine whether the proceedings are a means of implementation of FERC rules. If the purpose of the proceedings is to implement, the court has no discretion, it does not have jurisdiction. The Ratepayer Advocate argued that the purpose of the Board proceeding was to implement PURPA's and FERC's rules prohibiting power purchase prices above the "just and reasonable" level or above the relevant PURPA/FERC ceiling. The Third Circuit was at least obliged to consider the argument, but it did not. (See footnote 3 of the decision. (A-4). According to *FERC v. Mississippi*, *supra*, the Board appropriately initiated and held these hearings in order to carry into effect the relevant FERC rules governing this power purchase.

Under PURPA § 210(g)(1), 16 U.S.C. § 824a-3(g)(1), Congress stated that no court of the United States shall have jurisdiction over actions in connection with a proceeding of a state regulatory commission implementing the rules prescribed by FERC for the purchase, and pricing of the purchase, of QF electricity under PURPA. Under this section of PURPA, it was incumbent upon the Third Circuit to review the record before it, including FCA-18, to determine whether there was an obstacle to the exercise of jurisdiction over this matter. Not only did the Third Circuit not give consideration to this uncontested evidence, the Court did not even acknowledge its existence.

More important, however, is that the Third Circuit's decision is in serious conflict with the fundamental law of this Court:

> Objections to the jurisdiction of the court below when they go to the subject-matter of the controversy and not to the form merely of its presentation or to the character of the relief prayed, may be taken at any time. They are not waived because they were not made in the lower court.

*Miss. And Rum River Boom Co. v. Patterson*, 98 U.S. 403, 406, 25 L.Ed 206, 207 (1878). This principle should hold, *a fortiori*, because the uncontroverted evidence, FCA-18, which surfaced in the Board proceeding below, was part of the record before the Third Circuit and cited by the Ratepayer Advocate. As a consequence, the Third Circuit should have refrained from exercising jurisdiction and should have held that the District Court properly dismissed Freehold's complaint for want of subject-matter jurisdiction. (See the discussion of the second point under the reasons for granting the writ, *supra*).

**4. The Third Circuit Decision Held That a State Regulatory Commission May Not Implement the Relevant PURPA/FERC Ceiling Price in Connection with the Purchase of QF Electricity. This Holding Is in Conflict with the Decision of This Court in *American Paper Inst.* and the Decisions of Several State Supreme Courts.**

*American Paper Inst., supra*, held that the maximum price for the purchase of QF electricity was the relevant statutory limit and that a "just and reasonable" price could not as a matter of law exceed that statutory limit. That decision has served as a guide to several state Supreme Courts. See, *e.g.*, *Kansas City Power & Light v. State Corp. Com'n*, 234 Kan., 1052, 676 P.2d 764, 766 (Kan. 1984) and *State of North Carolina ex rel. Utilities Commission v. North Carolina Power*; 338 N.C. 412, 450 S.E.2d 896 (N.C. 1994). The Third Circuit had before it uncontroverted evidence (FCA-18) of a substantial disparity between the price in the power purchase agreement and the relevant Board-approved PURPA/FERC ceiling. In the grandfathering decision and the decision approving the Freehold/JCP&L power purchase agreement, the Board had specifically required JCP&L to offer to purchase Freehold's electricity at this unlawful price. The aforementioned document (FCA-18) had been sent by telecopier to the Board on the eve of the Board's "approval" of the agreement. The Third Circuit ignored this evidence and held that

once the Board "approved" the contract and found the purchase price to be "just and reasonable" and consistent with the relevant PURPA/FERC price, the Board could not reconsider the approval or deny the inclusion of the power purchase in rates to JCP&L's customers:

> . . . Finally, we hold that once the BRC [Board] approved the power purchase agreement between Freehold and JCP&L on the ground that the rates were consistent with avoided cost, just, reasonable, and prudentially incurred, any action or order by the BRC to reconsider its approval or to deny the passage of those rates to JCP&L's consumers under purported stated authority was preempted by federal law.

(A-28).

The Third Circuit did not give any reason for binding the ratepayers to what was a *per se* unlawful price. It ignored the claim that the Board's approval and the agreement were *per se* unlawful. If the Third Circuit had not done so, it would, of necessity, have been required to refrain from exercising jurisdiction over the Board proceeding. (See the discussion in the first point in the reasons for granting the writ, *supra*). The immediate upshot of the Third Circuit's decision is a compounded violation of PURPA—it ratifies a Board proceeding which did not implement FERC rules and bars a Board proceeding intended to implement those rules.

Congress made explicit its intention that under PURPA the ratepayers were not to subsidize cogenerators. It further commanded that the FERC rules should *insure* that the purchase price was "just and reasonable". This Court held that "just and reasonable" could not exceed the statutory limit—the avoided cost to the utility of alternative sources of power at the time that the agreement becomes legally enforceable. (See the discussion in the first point under the reasons for granting the writ, *supra*, for statement of Congressional intent that the prohibitions are intended for the benefit of ratepayers). By looking away from compelling evidence of illegality in the

pricing of the power purchase agreement and forbidding the Board from "revisiting" these issues, the Third Circuit *insured* that the ratepayers of JCP&L would subsidize Freehold and *insured* that the rates were *per se* unreasonable and unjust, and, therefore, *per se* unlawful. Concisely, the Third Circuit's decision ratified a power purchase which accomplished precisely the opposite of what Congress had intended to accomplish by legislating PURPA, and aborted a proceeding to carry into effect that Congressional purpose. The Third Circuit's decision, if not reversed, will also perpetuate the compound contravention of Congressional design into the future by embedding the grossly overpriced cost of the Freehold/JCP&L power purchase agreement in the rates paid by JCP&L's ratepayers.

## CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari on the two questions presented.

Respectfully submitted,

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IN THE
# Supreme Court of the United States

OCTOBER TERM, 1994

JERSEY CENTRAL POWER & LIGHT COMPANY,

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v.

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ON PETITIONS FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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July 5, 1995

20 pp

## QUESTION PRESENTED

Whether Section 210(e) of the Public Utility Regulatory Policies Act of 1978 ("PURPA") and the Federal Energy Regulatory Commission's implementing regulations, which exempt qualifying cogeneration facilities from state rate regulation, preempt the New Jersey regulatory agency from modifying the rates of a qualifying cogeneration facility in a long-term contract where those rates were "locked-in" and approved by the agency under another provision of PURPA in orders that were not challenged and that have become final and nonappealable.

## RULE 29.1 LIST

Respondent Freehold Cogeneration Associates, L.P. ("Freehold") is a limited partnership. Constellation Energy, Inc., through wholly-owned subsidiaries, owns a 1 percent general partnership interest and a 49 percent limited partnership interest in Freehold. Constellation Energy, Inc. is a wholly-owned subsidiary of Constellation Holdings, Inc., which, in turn, is a wholly-owned subsidiary of Baltimore Gas & Electric Company, a publicly traded company. The other general partner in Freehold is APS Freehold, Inc., with a 1 percent general partnership interest. APS Freehold, Inc. is a privately held corporation. The remaining limited partnership interest in Freehold (49 percent) is held by APS Associates, L.P. APS Associates, L.P. comprises Advanced Power Systems, Inc., a privately held corporation owning a 98 percent general partnership interest, and Interstate Business Corporation and Wilson Securities Corporation, each a privately held corporation owning a 1 percent limited partnership interest.

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ON PETITIONS FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## RESPONDENT'S BRIEF IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

## STATEMENT OF THE CASE

### I. NATURE OF THE CASE

Respondent Freehold Cogeneration Associates, L.P. ("Freehold") is a "qualifying cogeneration facility" ("qualifying facility" or "QF") under the Public Utility

Regulatory Policies Act of 1978, Pub.L.No. 95-617, 92 Stat. 3117 (1978) ("PURPA"). Pursuant to one section of PURPA, the Federal Energy Regulatory Commission ("FERC") issued rules, to be implemented by the states, that established, *inter alia*, the rates that utilities must pay for the purchase of electricity from qualifying facilities. Pursuant to another section of PURPA, the FERC issued rules that are self-effectuating, *i.e.*, not to be implemented by the states, exempting QFs from all state laws and regulations respecting rates and financial and organizational regulation of utilities.

In 1992, the New Jersey Board of Regulatory Commissioners ("BRC") implemented the FERC rules by approving the rates contained in a long-term power purchase agreement ("PPA") between Freehold and Jersey Central Power & Light Company ("Jersey Central") for the life of the PPA. The BRC's order was never challenged and is final and nonappealable. Freehold contended, and the United States Court of Appeals for the Third Circuit held in the *"Freehold"* decision below,[1] that, once the rates in the PPA were determined by the BRC to be just and reasonable and prudently incurred for the life of the PPA in a final and nonappealable order, the BRC's implementation under PURPA ceased. Consequently, its requirement in 1994 that Freehold renegotiate those rates or submit to a hearing that would lead to a modification of the rates or withdrawal of the BRC's prior approval is preempted by PURPA and the FERC's implementing regulations. Those regulations specifically allow qualifying facilities to lock-in the rates for

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[1] *Freehold Cogeneration Associates, L.P. v. Board of Regulatory Commissioners of the State of New Jersey,* 44 F.3d 1178 (3rd. Cir. 1995). (Pet. App. A-1 - A-29).

the life of the contract and exempt qualifying facilities from rate regulation by the states.

The Third Circuit's decision below is consistent with PURPA and the FERC's implementing regulations and with the two high appellate court decisions that have addressed the issue of a state's right to revisit the rates in a QF contract once they have been established. There is no compelling reason to hear this case.

## II. THE STATUTORY AND REGULATORY SCHEME

### A. Federal Power Act

In 1935, the Congress enacted Part II of the Federal Power Act ("FPA"), 16 U.S.C. §§ 824-824k (1988), which delegated to the Federal Power Commission (now the FERC) the exclusive authority to regulate the rates for the transmission and sale at wholesale of electric energy in interstate commerce. *United States v. Pub. Utils. Comm'n of Cal.*, 345 U.S. 295 (1953). The legislation was a "direct result" of this Court's holding in *Pub. Utils. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) that the states lacked authority to regulate the rates for interstate sales of electricity for resale. *United States v. Pub. Utils. Comm'n of Cal.*, *supra*, 345 U.S. at 311. *See Jersey Central Power & Light Co. v. Fed. Power Comm'n*, 319 U.S. 61, 67-68 (1943); *Fed. Power Comm'n v. Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964).

## B. PURPA

In 1978 Congress passed PURPA as part of comprehensive national energy legislation to address the nation's energy crisis. *See Fed. Energy Reg. Comm'n v. Miss.*, 456 U.S. 742, 745-6 (1982). To make the nation more energy independent, the Congress determined that certain types of electricity production facilities were to be encouraged because they provide important benefits to society. *Id.* at 745-6, 750. Those facilities include small power production facilities that use renewable energy sources such as solar, wind, biomass and water, and cogeneration facilities that use fuel more efficiently by sequentially producing from that fuel both electricity and useful thermal energy (usually in the form of steam) for manufacturing or heating purposes. *Id.* at 750, n.11. PURPA represents a marked, albeit limited, departure from the traditional regulatory scheme, under which the FERC exercises exclusive jurisdiction over wholesale rates in interstate commerce. Under PURPA, the contract rates for a utility's wholesale purchases from QFs are determined according to regulations promulgated by the FERC, but implemented by state utility commissions.

### 1. Section 210 of PURPA

The QF provisions of PURPA reflect Congress' determination that there were two chief impediments to encouraging such non-utility energy producers: (1) utilities were reluctant to buy power from them; and (2) such power producers themselves were reluctant to shoulder the burdens of traditional utility regulation. *Id.* at 750-51. To overcome these impediments, Congress, in enacting Section 210 of PURPA ("Section 210"), provided a framework for federal and state implementation of utility purchase obligations and ratemaking principles, exemption from federal and state utility regulation, and certain judicial review mechanisms.

Section 210(a), 16 U.S.C. § 824a-3(a) (1988), directed the FERC to prescribe "such rules as it determines necessary to encourage cogeneration," which would require electric utilities to offer to purchase electric energy from, and sell back-up and other necessary energy to, such qualifying facilities.

Section 210(b), 16 U.S.C. § 824a-3(b), provides that the regulations promulgated by the FERC under Section 210(a) shall ensure that the rates for the purchase of power from a QF shall be "just and reasonable" to the electric consumers of the purchasing electric utility, and shall not exceed the incremental cost to the electric utility of alternative electric energy. This incremental cost of alternative electric energy is commonly referred to as the electric utility's "avoided cost."[2]

However, the conference committee report accompanying PURPA made it clear that in referring to the term "just and reasonable":

> It is not the intention of the conferees that cogenerators and small power producers become subject, by virtue of this language, and the rules promulgated under this section, to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their

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2 Section 210(d) defines the term "incremental cost of alternative electric energy" used in Section 210(b) for purchases from QFs as: "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source."

> electric power. The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis-à-vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.

H.R. Conf. Rep. No. 1750, 95th Cong. 2d. Sess. (Oct. 10, 1978) *reprinted in* 1978 U.S.C.C.A.N. (92 Stat.) 7831-32. The conference report continued:

> The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

*Id.* at 7832.

In keeping with this clear Congressional purpose, Section 210(e), 16 U.S.C. § 824a-3(e), authorizes the FERC to issue rules to exempt QFs from "state laws and regulations respecting the rates, or respecting the financial and organizational regulation of electric utilities" and from federal utility regulation.

Section 210(f), 16 U.S.C. § 824a-3(f), provides for state implementation of the FERC's rules promulgated under Section 210(a).

Section 210(g), 16 U.S.C. § 824a-3(g), specifies that judicial review respecting any proceeding conducted by a state regulatory authority for purposes of implementing any requirement under Section 210(a) can be had pursuant to the same conditions as specified under Section 123 of PURPA, 16 U.S.C. § 2633(a) (*i.e.*, in state court). Section

210(h)(2)(B), 16 U.S.C. § 824a-3(h)(2)(B), permits qualifying facilities to petition the FERC to enforce the state's implementation of the FERC's rules as mandated by Section 210(f) and, if the FERC does not initiate an enforcement action within 60 days, authorizes the QF to bring an enforcement action in the appropriate United States district court. Sections 210(g) and (h), therefore, by their terms specifically apply to review of the state implementation of the FERC's rules promulgated under Sections 210(a) and (f). Neither Section 210(g) nor (h) requires that proceedings respecting rules promulgated by FERC pursuant to Section 210(e), authorizing FERC to exempt QFs from certain regulation, be initiated in any particular forum.

### 2. The FERC's Rules Under Section 210(a) (Purchase at Avoided Cost)

In issuing rules under Section 210(a), the FERC determined that the rate at which a utility would be required to purchase power from QFs would be equal to the utility's full avoided cost. 18 C.F.R. §§ 292.101(b)(6), 292.304(b)(2) (1994). Upon a challenge to these regulations, this Court held that a rate for QF power equal to the utility's full avoided cost is just and reasonable to the electric consumers of the electric utility and fully in accordance with Sections 210(a) and (b) of PURPA. *Am. Paper Inst., Inc. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402 (1983).

The FERC's rules implementing Section 210(a) provide that if a QF sells electric energy or capacity pursuant to a legally enforceable obligation over a specified term, the rates for such purchases shall, at the option of the QF, be based on the utility's avoided costs as calculated either (1) at the time of the delivery of the power, or (2) at the time the obligation is incurred. 18 C.F.R. § 292.304(d)(2) (1994). The FERC's regulations further provide that, where

the rates are based on avoided costs calculated at the time the obligation is incurred (the so-called "lock-in" right), "the rates for such purchases do not violate [FERC's regulations or PURPA] if the rates for such purchases differ from avoided costs at the time of delivery." 18 C.F.R. § 292.304(b)(5) (1994).

Thus, the FERC explicitly recognized that a utility's avoided costs might change over time, but that any such change subsequent to the QF's incurring a legally enforceable obligation[3] to provide power to the utility would not cause that obligation to violate PURPA or the rules promulgated thereunder. *See Small Power Prod. and Cogeneration Facilities; Regulations Implementing Section 210 of PURPA*, Order No. 69, 45 Fed Reg. 12,214, 12,224 (Feb. 25, 1980) ("The import of this section is to ensure that a qualifying facility which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances."), *aff'd in part and vacated in part, Am. Elec. Power Serv. Corp. v. Fed. Energy Reg. Comm'n*, 675 F.2d 1226 (D.C. Cir. 1982), *rev'd in part, Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402 (1983); *West Penn Power Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,153 (1995); *New York State Elec. & Gas Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,027 (1995).

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3 The FERC used the term "legally enforceable obligation" in its rules to encompass obligations that did not rise to the level of an executed contract. As the Commission explained in its preamble to the regulations: "Use of the term 'legally enforceable obligation' is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible facility merely by refusing to enter into a contract with the qualifying facility." 45 Fed. Reg. at 12,224 (February 25, 1980).

### 3. Section 210(e) and the FERC's Rules Thereunder (Exemption from Utility Regulation)

To remove the second impediment to QF development identified by Congress, the burdens of traditional utility regulation, Section 210(e) authorizes the FERC to promulgate rules to exempt QFs from both federal and state utility regulation if it determines such exemption is necessary to encourage cogeneration and small power production. Pursuant to Section 210(e), the FERC issued rules exempting QFs from most federal utility regulation and from all state laws and regulations regarding rates and the financial and organizational regulation of utilities. 18 C.F.R. §§ 292.601 and 292.602 (1994).

## C. Implementation of the FERC's Rules

The provisions for implementing the FERC's rules are unusual. Section 210(f) provides that each state regulatory authority must implement the FERC's rules under Section 210(a) for each electric utility for which it has ratemaking authority. Thus, despite the fact that wholesale electricity rates are the exclusive province of the FERC, *see United States v. Pub. Utils. Comm'n of Cal., supra*, PURPA carved out a limited exception to this rule by requiring the states to implement one portion of the federal regulations under PURPA. *See Fed. Energy Reg. Comm'n v. Miss.*, 456 U.S. at 759-761.

# III. FACTUAL BACKGROUND

Freehold is constructing a qualifying cogeneration facility in Freehold, New Jersey. In 1989, the BRC issued an order (reproduced at App. A to this Brief) exempting, or "grandfathering," the Freehold project from the BRC's 1989 competitive bidding procedure for the acquisition of new

capacity for New Jersey utilities. As the 1989 order indicated, the new procedure expressly provided that the BRC would determine on a case-by-case basis whether to exempt a particular project, and Freehold was one of a number of projects that it exempted. Jersey Central opposed Freehold's request to be exempted, but did not appeal the BRC's order approving that request. Nor did the New Jersey Division of The Ratepayer Advocate ("DRA") or anyone else appeal. That order is final and nonappealable.

The BRC's 1989 order directed Freehold and Jersey Central to negotiate a contract with pricing tied to the benchmark price contained in Jersey Central's 1989 competitive bidding solicitation. After more than 2 years of negotiations, the parties signed the PPA on March 26, 1992.

On March 31, 1992, Jersey Central submitted the PPA to the BRC for approval (letter accompanying submittal is reproduced at App. B). In doing so, Jersey Central expressly argued that the contract rates should be protected for the life of the contract:

> Principles of equity dictate that the Board provide both the purchasing utility and the cogenerator with sufficient assurances that the avoided costs contract rate, once approved by the Board, will not be subject to further scrutiny. In this regard, FERC has indicated that neither the purchasing utility nor the QF are to be deprived of the mutual benefits of entering into a long-term contract based on Board approved avoided cost rates. In order to preserve the benefit of the bargain between the utility and the QF, flow-through of the purchased power costs incurred under this or similar agreements must be assured.
>
> In the instant case, both JCP&L and Freehold need to have the certainty that neither this nor future

> Boards will impair the utility's right to flow-through to and/or fully and timely recover from its ratepayers the contracted for, and Board-approved, purchase price over the full term of the Agreement or exercise jurisdiction over this or similar agreements.

App. B-3.

The BRC issued an order approving the PPA on July 8, 1992. (Reproduced at App. C). In that order, the BRC stated that "the price is equal to 100% of the applicable avoided cost" (App. C-5), and found that:

> the rates specified and the costs resulting therefrom [are] reasonable and reasonably and prudently incurred by JCP&L throughout the full term of the Agreement. Therefore the Board and its successors will allow JCP&L to flow-through and/or fully and timely recover the rates specified in the Agreement....

Id. (Emphasis added). Neither Jersey Central nor any other party, including the DRA, opposed approval of the PPA. Neither Jersey Central nor any other party sought appellate review of the Board's order approving the PPA. That order is final and nonappealable.

The BRC issued an order, dated April 12, 1993 (the "Towner Order"), directing electric utilities in New Jersey to assess their existing contracts with qualifying facilities under PURPA and to bring to its attention any contracts that the utilities believed no longer were economic. Jersey Central informed the BRC that the Freehold PPA might be a candidate for buyout or modification. Freehold then met with the BRC's staff and voluntarily agreed to certain price concessions in exchange for certain nonprice modifications to the PPA.

On January 4, 1994, the BRC issued an order pursuant to purported state authority rejecting the voluntary agreement between Freehold and the BRC's staff and directing Freehold and Jersey Central to renegotiate the rates in the PPA or to negotiate a buyout of the PPA. If no agreement was reached within thirty (30) days, the BRC would commence an evidentiary hearing to consider revoking its prior approval of the PPA. (Order reproduced at App. D). When no agreement was reached, the BRC issued an order commencing evidentiary hearings. (Order reproduced at App. E). The hearings continued from March, 1994 through the beginning of January, 1995, when they were halted as a result of the Third Circuit's decision below.

The Third Circuit's decision was a direct result of a Complaint filed by Freehold against the BRC and Jersey Central in the United States District Court for the District of New Jersey. The Complaint alleged that the BRC was preempted under PURPA and the FERC's implementing regulations from revisiting the order approving the PPA and the rates contained therein. The district court dismissed the Complaint on jurisdictional grounds.

## IV. THE DECISION BELOW

In a unanimous decision, the Third Circuit reversed the district court, finding that the court not only had jurisdiction, but also that federal law preempted the BRC from revisiting its prior approval of the PPA and its rates:

> Based on the overall scheme of PURPA and its stated goal, and especially section 210(e) and the implementing rules promulgated by the FERC, we hold that Congress intended to exempt qualified cogenerators from state and federal utility rate regulations.

*Freehold*, 44 F.3d at 1192. (Pet. App. A-24). The court found that once the BRC had completed its implementation of Section 210(a) by its 1992 order approving the PPA, its present attempt to modify the PPA or revoke its prior order constituted "exactly the type of regulation from which Freehold is immune under section 210(e)." *Id.*

The court went on to explain that its decision was consistent with two recent high appellate court decisions: *Indep. Energy Producers Ass'n v. Cal. Pub. Utils. Comm'n*, 36 F.3d 848 (9th Cir. 1984) and *Smith Cogeneration Management, Inc. v. Corp. Comm'n*, 863 P.2d 1227 (Okla. 1993). The court also reviewed the so-called "regulatory-out" clause in the PPA, which it found to be "unambiguous," and determined that:

> this clause does not purport to confer on the BRC any jurisdiction it would not otherwise have. In particular, it reflects no intent on the part of Freehold to surrender any of the protection from state rate regulation conferred upon it by section 210(e).

*Freehold*, 44 F.3d at 1194 (Pet. App. A-28).

Jersey Central, the BRC, and the DRA filed a request for rehearing of the panel and of the Third Circuit *en banc*, which was denied on March 7, 1995. Two weeks after rehearing was denied, Jersey Central filed a petition with the FERC, asking the FERC to void the PPA notwithstanding the Third Circuit's decision. That petition is still pending. Jersey Central and the DRA filed their petitions for a writ of certiorari with this Court on June 5, 1995. The BRC did not file a petition.

## REASONS FOR DENYING THE WRIT

### I. NEITHER THE NEW JERSEY BOARD OF REGULATORY COMMISSIONERS, THE APPELLEE BELOW, NOR THE FEDERAL ENERGY REGULATORY COMMISSION, THE AGENCY WHOSE RULES ARE BEING APPLIED, ARE CHALLENGING THE THIRD CIRCUIT'S HOLDING

As discussed *supra* in the Statement of the Case, the issue in this case is whether the actions of the BRC are preempted by PURPA and the implementing regulations promulgated by the FERC. Tellingly, the New Jersey state agency whose actions are at issue here appears to have accepted the decision of the Third Circuit. Conspicuously absent from these proceedings is a petition by the BRC for a writ of *certiorari*, an absence that suggests that the BRC can live with the *Freehold* decision.[4]

Similarly, the federal government is not troubled by the merits of this case. In response to the Third Circuit's request below to brief the jurisdictional issues and "any of the other issues raised by this appeal that it desires to" (*See* App. F to this Brief for the text of the court's order), the FERC filed a brief *amicus curiae* addressing the jurisdictional issues in the case but expressly declined the court's invitation to address the merits. On all the jurisdictional issues, the FERC sided with Freehold, advocating the same position that the court ultimately adopted. (The FERC's *amicus* brief is

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4 On June 26, 1995, the BRC filed Notices of Appearance with this Court in these proceedings in which it specifically stated that it would not be filing a brief in this matter.

reproduced at App. G). More recently, the FERC has cited the Third Circuit's decision with approval. *See, e.g., Conn. Light & Power Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,035 at 61,152 (1995) (the Third Circuit's *Freehold* decision "supports our conclusion").

Both the BRC's and the FERC's acceptance of the Third Circuit's decision fully justifies this Court's denial of the writ.

## II. THE THIRD CIRCUIT'S HOLDING IS FULLY CONSISTENT WITH THE OTHER HIGH APPELLATE COURT DECISIONS THAT HAVE ADDRESSED ATTEMPTS TO REVISIT AN APPROVED QF CONTRACT

The Court of Appeals' decision, far from conflicting with the decisions of other appellate courts and the FERC, as suggested by Jersey Central (Pet. at 13), is fully consistent with the two other high appellate court decisions that have addressed whether a state may reconsider the rates paid to a QF under a power purchase contract.

In *Indep. Energy Producers Ass'n, Inc. v. Cal. Pub. Utils. Comm'n*, 36 F.3d 848 (9th Cir. 1994), the United States Court of Appeals for the Ninth Circuit struck down a program under which the California Public Utilities Commission ("CPUC") permitted the utilities to reduce the rates paid to QFs under long-term contracts if the utilities determined that the QFs did not meet certain criteria established by the FERC's regulations implementing PURPA. In reviewing the program, the court observed that:

> The underlying motivation behind the CPUC program is to lower the rates set in [the utilities'] standard offer contracts because they are higher than the Utilities' current avoided costs. [T]his differential

> exists because the standard offer contracts lock the Utilities into paying rates that were calculated on incorrect assumptions about the future cost of fossil fuels.

*Id.*, 36 F.3d at 858. As to that "underlying motivation," however, the court found that, notwithstanding the "incorrect assumptions" attendant to the original approval of the contract, PURPA and the FERC's implementing regulations precluded the CPUC and the utilities from unilaterally changing the rates once they had been locked-in by contract:

> The fact that the prices for fuel, and therefore the Utilities' avoided costs, are lower than estimated, does not give the state and the Utilities the right unilaterally to modify the terms of the standard offer contract. * * * [In promulgating its regulations implementing PURPA, t]he Commission recognized that, at times, the avoided cost rate provided in the contract might be greater or less than the utility's current avoided costs but that certainty as to rate was important....

*Id.*, 36 F.3d at 858 (Citing to the FERC's preamble to its PURPA rules). This is consistent with the holding of the Third Circuit below. *See Freehold*, 44 F.3d at 1194 (Pet App. A-28 - A-29). Once Freehold and Jersey Central established the rates in the PPA and the BRC's order approving those rates became final and nonappealable, the BRC and Jersey Central were precluded from changing those rates unilaterally.

The Third Circuit's holding also is consistent with a recent decision of Oklahoma's highest court. *Smith Cogeneration Management, Inc. v. Corp. Comm'n*, 863 P.2d 1227 (Okla. 1993). There the court held that PURPA deprives the state regulatory commission of authority to revisit the avoided cost rates in a QF contract once they have

been established. *Id.*, 863 P.2d at 1241. The court invalidated a state regulatory commission rule that required utilities to include in their contracts with QFs a clause allowing the commission to modify the terms and conditions of the contract during the term of the contract. It found that "[r]econsideration of long-term contracts with established estimated avoided costs imposes utility-type regulation of QFs. PURPA and FERC regulations seek to prevent reconsideration of such contracts." *Id.*, 863 P.2d at 1240. The court concluded that the "Corporation Commission rules, to the extent which they require qualifying facilities to include a notice provision allowing reconsideration of avoided costs after the contract is agreed upon, are preempted by federal law." *Id.*, 863 P.2d at 1242. The analysis and conclusion of the Oklahoma court apply equally to the BRC's attempt to revisit Freehold's rates nearly two years after approving them in a final and nonappealable order, as the Third Circuit correctly held. *See Freehold*, 44 F.3d at 1193 (Pet. App. A-25 - A-26).

## III. THE THIRD CIRCUIT'S DECISION IS CONSISTENT WITH RECENT DECISIONS BY THE FERC INTERPRETING PURPA AND ITS REGULATIONS

The Third Circuit's decision also is fully consistent with the interpretation of PURPA and its regulations advanced by the FERC, the agency charged with implementing and administering the statute. On several recent occasions, the FERC has considered and rejected requests by utilities to declare the rates contained in their power purchase contracts with QFs to be invalid. *See, e.g., West Penn Power Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,153 (1995); *New York State Elec. & Gas Corp.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,027 (1995) (*"NYSEG"*); *Metro. Edison Co./Penn. Elec. Co.*, Docket

No. EL95-41-000 (approved by vote of the FERC on June 28, 1995).[5]

In *NYSEG*, for example, the utility sought an order from the FERC to relieve it of its obligation to purchase energy from two QFs at rates that had been established in separate power purchase contracts that had been approved by the state commission in final and nonappealable orders. The utility's purported justification for its request was that circumstances had changed since the contracts were executed, resulting in a situation in which the rates contained in the contracts exceeded its then-current avoided cost. The FERC denied the utility's petition, holding that, under its regulations, the contract rates were established (*i.e.*, "locked-in") at the time of contracting.

Specifically, the FERC noted that its regulations provide that the rates under a power purchase contract do not violate PURPA if they differ from avoided costs at the time the electricity is delivered. 71 Fed. Energy Reg. Comm'n Rep. at 61,116, citing 18 C.F.R. § 292.304(b)(5) (1994). Those regulations were promulgated in the belief that "in the long run, 'overestimations' and 'underestimations' will balance out" and that the lock-in of the rates would "ensure that a [QF] which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances." *Id.*, citing *Small Power Prod. and Cogeneration Facilities*, 45 Fed. Reg. at 12224 (Feb. 5, 1980). (See App. H to this Brief for text of *NYSEG* order.)

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5 Metropolitan Edison Company and Pennsylvania Electric Company are utility affiliates of Jersey Central and are owned by a common parent, General Public Utilities Corp.

This is the same holding as that adopted by the Third Circuit below: once the purchase rates for electricity sold by a QF to a utility have been locked-in and approved, those rates may not be changed unilaterally by the utility or the state commission as a result of changed circumstances. *See also West Penn*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) at 61,495-96 (rejecting utility's assertion that changed circumstances -- *i.e.*, decreases in its projections of avoided cost from those contained in power purchase contract with the QF -- justified reduction of the rates it paid under that contract, which had been approved by the state commission in a final and nonappealable order). (*See* App. I to this Brief for the text of the *West Penn* order.)

## IV. JERSEY CENTRAL'S ALLEGATIONS OF A LARGE DISPARITY BETWEEN AVOIDED COSTS AND THE RATES THAT IT WILL PAY UNDER THE PPA ARE WHOLLY UNSUBSTANTIATED AND ARE IRRELEVANT IN ANY EVENT

Jersey Central argues that this Court should grant the writ because of the "disbenefits" that the PPA allegedly will cause to Jersey Central's ratepayers (Pet. at 8, 13-14). Jersey Central completely fails, however, to offer any support for its claims.

Jersey Central argues that at the time the BRC approved the PPA in 1992, the rates specified therein exceeded its avoided cost. When Jersey Central submitted the PPA for BRC approval, however, it never suggested that the rates exceeded its avoided cost. Indeed, it argued that the rates contained in the PPA should be protected for the life of the PPA. See Factual Background, *supra*, at 9-12. When the BRC approved the PPA, it specifically held that the rates were "equal to 100% of the applicable avoided cost." (App.

C-5). No party challenged that determination. Even when the BRC sought to revisit the rates under the PPA, it did so on the basis that estimates of avoided costs had declined since the PPA was approved (*see* App. D-4, 11, 12, E-2), rather than on any alleged mismatch at the time of contracting. Thus, Jersey Central's claim amounts to little more than a *post hoc* rationalization that rings hollow here.

PURPA was enacted because utilities refused to deal with cogenerators and small power producers. *Fed. Energy Reg. Comm'n v. Miss.*, 456 U.S. at 750-51. Absent PURPA, there would have been no cogeneration contracts. The utilities would have continued their construction on the traditional "cost plus" basis and there would have been no competition for generating capacity. PURPA helped to establish the competitive market for generation by requiring utilities to stop their anticompetitive actions and start acting in the best interests of the nation. In the absence of cogeneration, traditional utility construction would have led to far higher rates for electric consumers.[6]

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6 Jersey Central's claim (Pet. at 14) that the PPA will result in excessive costs to ratepayers compared to current market alternatives is wildly inaccurate. Under the utility's market test, nearly all of Jersey Central's existing generating capacity would be found to be excessively expensive as well. Moreover, Jersey Central neglects to point out that, absent PURPA, utilities would have continued to build plants like the Three Mile Island II nuclear unit, partly owned by Jersey Central, which has cost ratepayers hundreds of millions of dollars without providing any electricity. Under the PPA, in contrast, Freehold only gets paid if it performs properly. As for the *Wall Street Journal* article cited by Jersey Central (Pet. at 14), the reporter was demonstrably biased, focusing primarily on exotic technologies that have experienced problems, not on the hundreds of conventional cogeneration plants, like the Freehold project, that have provided and will provide reliable, cost-effective power.

Further, to the extent that there have been decreases in avoided costs since the rates under the PPA were locked-in, as Jersey Central has suggested (Pet. at 8), the FERC, in its implementing rules, specifically contemplated that such changes might occur, but found that the potential for such changes was outweighed by the importance of providing the certainty required for financing of QF projects. *See Small Power Prod. and Cogeneration Facilities*, 45 Fed. Reg. at 12,224; *NYSEG, supra.*

In any event, the relationship between Jersey Central's current avoided cost and the rates under the PPA is irrelevant for purposes of this case. As is discussed in greater detail *infra*, once the BRC approved the rates in a final and nonappealable order, its implementation of the FERC's avoided cost regulations was at an end. Section 210(e) of PURPA and the FERC's regulations promulgated thereunder at 18 C.F.R. § 292.602(c) (1994) specifically exempt Freehold from state rate regulation. Consequently, the BRC lacks authority to modify the rates in the approved PPA, as the Third Circuit correctly held.

## V. FERC'S IMPLEMENTING REGULATIONS ARE NO LONGER SUBJECT TO CHALLENGE

The provisions of Section 210 of PURPA are not self-implementing. Rather, PURPA Section 210 is given effect through the issuance of rules by the FERC. These rules have the "force of law." *See United States v. Nixon*, 418 U.S. 683, 694-96 (1974). Thus, Jersey Central's reference to the statutory requirements of PURPA instead of the FERC's implementing regulations (Pet. at 22) is unavailing.

The FERC issued its regulations respecting the rates for the purchase of power from QFs, including the right of a QF to the "lock-in" estimates of avoided cost, in 1980. They were affirmed by this Court in 1983. *Am. Paper Inst., supra.*

For 15 years, these rules have been consistently applied and relied upon by an entire industry. It is far too late to challenge them now. Indeed, the United States Court of Appeals for the District of Columbia Circuit, on review of the FERC's rules implementing PURPA, expressly observed in 1982 that the time to challenge them was when they were promulgated, not years later:

> Thus, if petitioners fail to pursue their remedies now, they do so at their peril of losing the right ever to challenge the validity of the Commission's regulations.

*Am. Elec. Power Serv. Corp. v. Fed. Energy Reg. Comm'n*, 675 F.2d 1226, 1232 (D.C. Cir. 1982), *rev'd on other grounds sub nom., Am. Paper Inst. v. Am. Elec. Power Serv. Corp.*, 461 U.S. 402 (1983). *See also NYSEG*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) at 61,116 (App. H-32), ("It is now far too late in the Commission's implementation of PURPA for NYSEG to argue, for the first time, that these particular regulations have legal and policy flaws requiring that we abrogate contracts entered into under these regulations.") (emphasis in original).

## VI. FREEHOLD PRESENTED A VALID CLAIM THAT IT IS EXEMPT FROM RATE REGULATION UNDER SECTION 210(e)

### A. As an Action Under Section 210(e) of PURPA, Jurisdiction Over This Matter Properly Resided with the Federal Courts

The Third Circuit correctly held that the district court had jurisdiction over Freehold's claim and that the jurisdictional bar contained in Section 210(g) applies only to those portions of Section 210 that require utilities to purchase energy from and sell energy to qualifying facilities (Section 210(a)), and to the requirement that state authorities implement the federal rules (Section 210(f)).

Freehold did not challenge the BRC's implementation pursuant to Section 210(f) of the FERC's rules under Section 210(a). Rather, Freehold brought this proceeding under Section 210(e) and the FERC's rules implementing that section, 18 C.F.R. § 292.602(c) (1994). Indeed, the BRC admits that the challenged order of the BRC was not issued to implement the FERC's rules, but pursuant to purported state law.[7] See App. D-12, E-6, E-7. In its brief *amicus curiae* to the Third Circuit, the FERC agreed that Freehold presented a valid claim under Section 210(e), and that the federal court had jurisdiction over that claim. *See* App.

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7 The BRC consistently has cited state law as its authority to hold the hearings to revise or revoke the PPA. (*e.g.*, App. D-12, E-6, 7). Further, in arguing in the district court against the assertion of federal jurisdiction over this matter, the BRC consistently invoked its purported powers under state law, 48:2-40, to "revoke or modify an order made by it." There thus can be no legitimate dispute that the BRC proceeded under state law to regulate Freehold's rates.

G-14. *See Shaw v. Delta Airlines*, 463 U.S. 85 (1983) ("It is beyond dispute that federal courts have jurisdiction over suits to enjoin state officials from interfering with federal rights...").

In asserting that Section 210(g) of PURPA deprives the federal courts of jurisdiction, Jersey Central mischaracterizes the holding in *Bristol Energy Corp. v. N.H. Public Utils. Comm'n*, 13 F.3d 471 (1st Cir. 1994). In *Bristol Energy*, the First Circuit, on review, held that the federal courts have jurisdiction over a Section 210(e) claim:

> We have considered -- and we reject -- PUC's argument that 16 U.S.C. § 824a-3(g) divests federal courts of jurisdiction. Section 824a-3(g) places limits on federal jurisdiction in proceedings involving rules implementing 16 U.S.C. §§ 824a-3(a) and -3(f), rules not at issue in this case.... We conclude that federal question jurisdiction exists in this case, ... because plaintiffs allege a preemption claim and seek to enjoin state officials from interfering with a federal right, i.e., the QF exemption.

13 F.3d at 474 (emphasis supplied). The QF exemption is the Section 210(e) exemption.

The jurisdictional issue in the present case is virtually identical to that in the *Bristol Energy* case. On that issue the First Circuit determined that the limitations on federal jurisdiction imposed by Section 210(g) are inapplicable where, as here, plaintiffs "allege a preemption claim and seek to enjoin state officials from interfering with a federal right,

*i.e.*, the QF exemption." *Id.*[8] The Third Circuit reached the same result below. *See also Indep. Energy Producers, supra,* (district court exercised jurisdiction to hear a claim that the state agency action that permitted modification of approved QF contract rates was preempted by PURPA).

### B. The BRC Impermissibly Sought to Regulate Freehold's Rates After They Had Been Locked-In and Approved

In its January 5, 1994 order directing Jersey Central and Freehold to negotiate a buy-out or reformation of the PPA (App. D) and in its March 7, 1994 order instituting proceedings to reform the rates under the PPA or revoke its earlier approval of the PPA (App. E), the BRC impermissibly attempted to regulate the rates to be paid by Jersey Central to Freehold under the PPA. Indeed, the BRC's express reason for ordering negotiations and commencing the hearing was because of its view that the rates contained in the PPA exceeded the then-current avoided cost of Jersey Central. *See* App. D-11. Further, both orders were issued under purported authority of the New Jersey regulatory statute. App. D-12, E-7. Nowhere in either order does the Board suggest that its inquiry constitutes continued implementation of PURPA or give any indication that the actions are being pursued under any authority other than state law. Any such state law or regulation that would permit the BRC to modify the rates under the PPA is precisely the type of law or regulation (*i.e.*, those respecting

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8 On the merits, the First Circuit addressed the authority to compel disclosure of data under section 712 of the Energy Policy Act of 1992, a statute that is not implicated in this case.

"rates") from which QFs such as Freehold specifically are exempted pursuant to Section 210(e) of PURPA and the FERC's regulations. Consequently, as the Third Circuit correctly held, the BRC's attempt to modify the rates under the PPA constituted regulation of Freehold's rates, an activity that expressly is preempted by Section 210(e).[9]

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9 Jersey Central, relying on *N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S.Ct. 1671, 1682 (1995) and *Cippolone v. Liggett Group, Inc.*, 112 S.Ct. 2608 (1992), argues that the Third Circuit improperly expanded the preemptive effect of PURPA Section 210(e). In fact, neither of these cases supports Jersey Central's claims. Jersey Central cites *Blue Cross*, a case interpreting the preemptive effect of ERISA, for the proposition that the Third Circuit disregarded the presumption that Congress did not intend to supplant state law. In this case, however, it is beyond cavil that Section 210(e), as implemented by the FERC's regulations, expressly exempts QFs from all "State laws and regulations respecting the rates . . . of electric utilities." Consequently, any such presumption is overcome by the plain language of the statute.

Similarly, Jersey Central cites *Cippolone* for the proposition that the Third Circuit has expanded the preemptive scope of Section 210(e) beyond its "express" preemption of "utility-type" regulation to matters beyond the reach of that section. In fact, nowhere in the language of Section 210(e) or the FERC's implementing regulations is there any "express" language discussing "utility-type" regulation. Indeed, despite Jersey Central's attempt to limit "utility-type" regulation to some form of the traditional "cost-of-service" rate regulation to which utilities historically have been subject, that term is nowhere defined in the statute or regulations. Rather, the language of Section 210(e) and 18 C.F.R. § 292.602(c)(1) (1994) plainly exempts QFs from all state laws and regulations "respecting" the "rates" of electric utilities. Thus, to the extent that the BRC attempted, under color of state law, to modify the "rates" contained in the PPA, its action expressly was preempted by PURPA, as the Third Circuit correctly held.

## VII. THE "REGULATORY OUT" CLAUSE OF THE PPA DOES NOT CONFER ON THE BRC POWER TO ALTER QF RATES

The so-called "regulatory out" clause contained in Section 20.2(a) of the PPA,[10] by its plain terms, cannot be read as an affirmative grant of authority to the BRC (or, for that matter, to the FERC or any other agency) to regulate Freehold's rates in a manner that otherwise would be impermissible under PURPA and the FERC's regulations, in particular 18 C.F.R. § 292.602(c), exempting qualifying facilities from state laws respecting the rates of electric utilities. The provision does not state that the BRC is granted the right to modify the contract rates or to deny Jersey Central the right to recover from its ratepayers payments made by Jersey Central under the PPA. The provision merely states that, "in the event that the BRC, the FERC or any legislative, judicial, administrative or other governmental agency having jurisdiction over the parties, the Agreement or the transactions contemplated thereby, should disallow in whole or in part or otherwise impair the full and timely recovery by the Company from its customers...", one of several options shall be implemented. The provision does no more than refer to whatever valid jurisdiction exists independently of the contract and address the allocation of risks steming from any exercise of that valid jurisdiction. All parties (plus the Third Circuit) agreed that the clause was unambiguous. The Third Circuit correctly held that "this clause does not purport to confer on the BRC any jurisdiction it would not otherwise have." 44 F.3d at 1194. (Pet. App. A-28). As previously explained (*see* pp. 19-21,

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10 Section 20.2(a) of the PPA is quoted in full in the Third Circuit's decision below. 44 F.3d at 1193, n.12 (Pet. App. A-27, n.12).

*supra*), the BRC had no preexisting authority to revisit the QF rates it had approved years before.

## VIII. THE DIVISION OF THE RATEPAYER ADVOCATE'S CLAIM THAT THE BRC'S APPROVAL OF THE PPA WAS ULTRA VIRES IS BASELESS AND, IN ANY EVENT, UNTIMELY RAISED

The DRA asserts that the PPA is "void ab initio" because the BRC approved rates that were too high and the BRC's action therefore was "ultra vires". (Pet. at 4). This argument is insubstantial. First, the DRA did not raise its ultra vires argument before the district court. Consequently, as the Third Circuit correctly held, 44 F.3d at 1182, n.3 (Pet. App. A-4, n.3), the DRA failed to preserve the issue on appeal and therefore was barred from raising it before the Third Circuit and likewise is barred from raising it here. *See Duignan v. United States*, 274 U.S. 195, 200 (1927) ("It is only in exceptional cases coming here from the federal courts that questions not pressed or passed upon below are reviewed.") Secondly, the DRA's claim is belied by the BRC's express statement in its order approving the PPA that the rates were "equal to 100% of the applicable avoided cost." (App. C-5). The DRA did not challenge Jersey Central's petition for approval of the PPA or the BRC's order approving it, which is final and nonappealable.

## CONCLUSION

For the foregoing reasons, the Petitions for a Writ of Certiorari filed by Jersey Central and the DRA should be denied.

Respectfully submitted,

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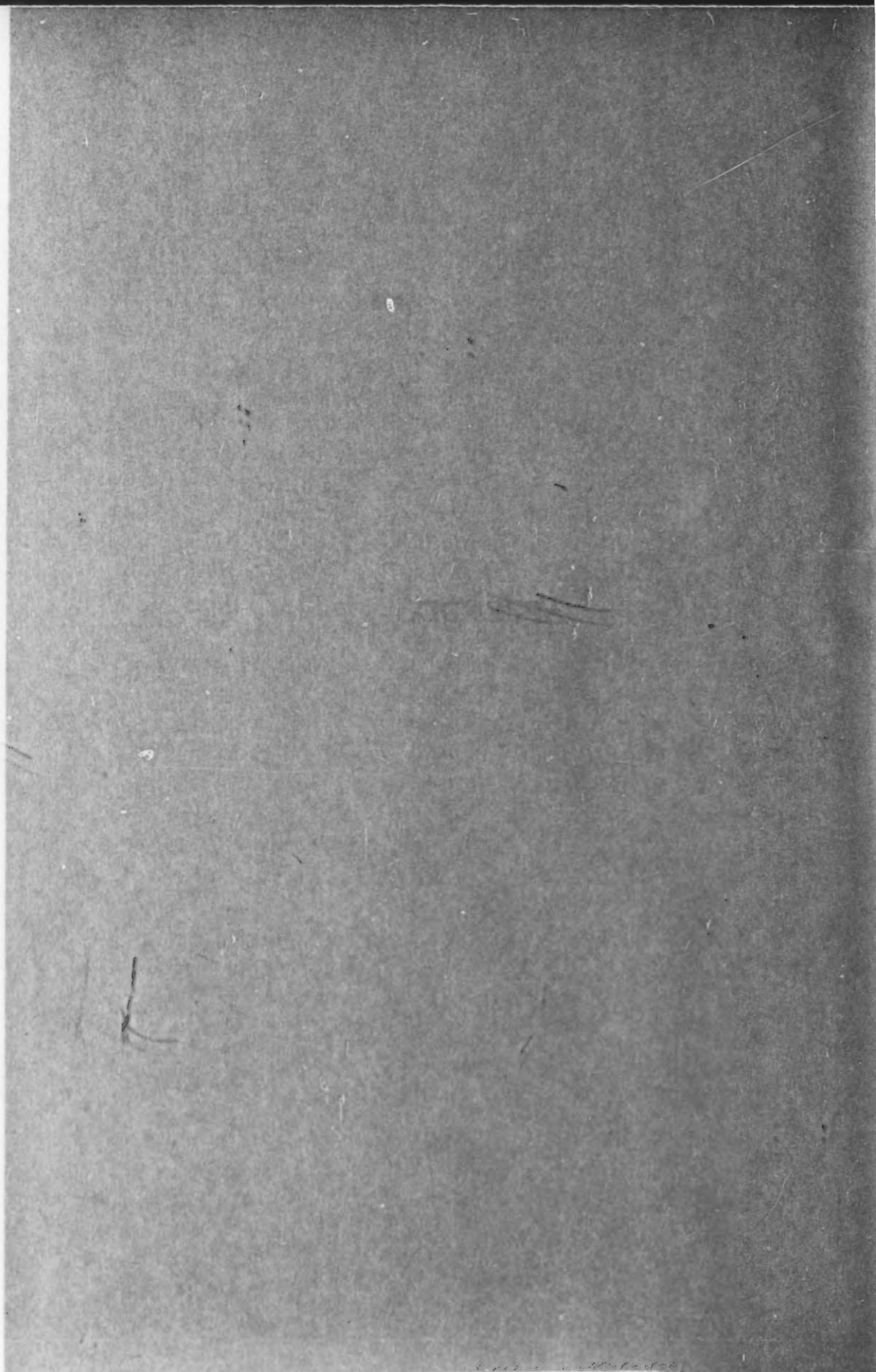
# APPENDIX



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|---|---|
| **APPENDIX A** | New Jersey BRC Decision of July 31, 1989 |
| **APPENDIX B** | Jersey Central Letter of March 31, 1992 to New Jersey BRC |
| **APPENDIX C** | New Jersey BRC Decision of July 8, 1992 |
| **APPENDIX D** | New Jersey BRC Decision of January 5, 1994 |
| **APPENDIX E** | New Jersey BRC Decision of March 7, 1994 |
| **APPENDIX F** | Order in No. 94-5168, USCA for the Third Circuit, dated April 26, 1994 |
| **APPENDIX G** | FERC Brief *Amicus Curiae* in No. 94-5168, USCA for the Third Circuit |
| **APPENDIX H** | FERC Order in New York State Electric & Gas Corp., Docket No. EL95-28-000, dated April 12, 1995 |
| **APPENDIX I** | FERC Order in West Penn Power Company, Docket No. EL95-30-000, dated May 8, 1995 |

# APPENDIX A

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES
Two Gateway Center
Newark, N.J. 07162

| | | |
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| IN THE MATTER OF | ) | ELECTRIC/LEGAL |
| THE CONSIDERATION | ) | ORDER REGARDING |
| AND DETERMINATION | ) | MOTION FOR |
| OF COGENERATION | ) | RECONSIDERATION |
| AND SMALL POWER | ) | OF DENIAL OF |
| PRODUCTION STANDARDS | ) | GRANDFATHER |
| PURSUANT TO THE | ) | STATUS |
| PUBLIC UTILITY | ) | |
| REGULATORY POLICIES | ) | BPU Docket No. |
| ACT OF 1978 | ) | 8010-687B |

Carella, Byrne, Bain & Gilfillan, by Arthur T. Vanderbilt, III, Esq., Roseland, New Jersey, and Huber Lawrence and Abell, by Blossom A. Peretz, Esq., New York, New York, for Enserch Development Corporation and Turner Power Corporation

Kirsten, Simon, Friedman, Allen, Cherin & Linken, by John K. Enright, Esq., Newark, New Jersey, for Jersey Central Power & Light Company

BY THE BOARD:

On September 28, 1988, this Board issued two orders in Document No. 8010-687B. The first order adopted a Stipulation of Settlement which set forth a revised set of procedures under which New Jersey investor owned electric utilities would select and purchase electric capacity and

energy from qualified cogeneration and small power production facilities, independent power producers and large scale conservation projects. Said stipulation provided at page 10:

> In addition, the provisions of this Settlement Agreement shall not be applicable to proposed APP capacity which may, as determined on a case by case basis, be grandfathered and subject to Board policies and procedures regarding cogeneration and small power production in effect prior to the effective date of this agreement.

The second order issued on September 28, 1988, in turn, designated a number of projects to be grandfathered. In reviewing projects that were in development but were without power purchase agreements, the Board considered the following criteria in determining whether grandfathered status should be granted: (1) whether ratepayers would be better off if a particular project was grandfathered, i.e., whether the grandfathering of that project was in the public interest; (2) whether negotiations between a project and a utility have resulted in a firm pricing agreement; and (3) the effect that grandfathering would have on the development of the project.

On October 12, 1988, Ebasco Services, Inc. (Ebasco) filed a Motion for Reconsideration requested modification of the Board's September 28, 1988 order by grandfathering the cogeneration project being jointly developed by Enserch Development Corporation (Enserch), an affiliate of Ebasco, and Turner Power Corporation (Turner) at the Nestle Foods Corporation (Nestle) plant in Freehold, New Jersey (the Freehold Project).[1] This project contemplates a 100 megawatt cogeneration facility to serve the electric and

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1 For purposes of discussion, the name "Enserch" will be used to identify the movants in this matter.

thermal needs of Nestle with any excess electrical energy and capacity produced by the facility to be sold to Jersey Central Power & Light Company (JCP&L).

By letter dated November 30, 1988, the Board was advised that Enserch had changed counsel and was requested to "defer action on the Motion for Reconsideration for several weeks to afford (counsel for Enserch) the opportunity to review the filing in this matter and determine if it should be supplemented or amended."

Under cover letter dated January 27, 1989, Enserch filed a Supplemental Motion for Reconsideration for the stated purpose of providing the Board ". . . with complete information regarding the history of the Freehold Project, which had not been included in the Motion filed on October 12, 1988, in order to assist the Board in its analysis regarding grandfathering the Freehold Project, so as to demonstrate to the Board that the Freehold Project meets the criteria for grandfathering." JCP&L has opposed the relief requested by Enserch essentially for the reason that, in the opinion of the utility, no firm pricing agreement had been reached between the parties. In addition, Enserch filed a motion dated May 4, 1989, in which it requested the Board to compel JCP&L to continue negotiations in this matter.

Subsequent to the filing of the Supplemental Motion for Reconsideration, the parties have held several meetings which were attended by Board staff and have submitted additional information with the Board.

In its initial moving papers, Enserch argued that the Board had erred by: (1) failing to provide a "reasoned explanation" for the selection of the grandfathering criteria; (2) selecting "patently unsatisfactory" grandfathering criteria; (3) failing to provide a reasoned explanation for its selection of grandfathered qualifying facilities; and (4) failing to

grandfather the Freehold Project based upon the selected criteria set forth in the Board's Order. Enserch further argued that as the September 28, 1988 Decision and Order constituted either a final decision in a contested case or the culmination of a rulemaking proceeding, the Board erred by failing to comply with the procedures set forth in the New Jersey Administrative Procedures Act. N.J.S.A. 52:14B-1 et seq. While we believe that our decision herein renders these arguments moot, we pause briefly to respond thereto.

As indicated hereinabove, the Stipulation of Settlement provided that the Board would determine, on a case by case basis, which projects, if any, would be grandfathered and, therefore, be subject to the Board policies and procedures theretofore in effect. We believe that the criteria set out by the Board are fair and practical based upon the history of and the circumstances surrounding this proceeding and the affected projects. These criteria reflect the Board's central statutory responsibility to ensure that the ratepayers receive safe, adequate and proper service at just and reasonable rates, and the Board's strong policy concern, as well as its obligations under PURPA and the pertinent regulations promulgated thereunder (e.g., 18 C.F.R. 292.401), to encourage cogeneration. It was the considered opinion of the Board that the status of these projects specifically set out in the Board's Decision and Order of September 28, 1988, and the attending benefit to the public interest inherent there: as sources of reliable and economical electric power, warranted those projects being grandfathered without the need for further review or the submission of addition information. This determination, however, did not prejudice or preclude the opportunity of any other developer, including Enserch, to request through a formal filing, that the Board find that its project should similarly be grandfathered.

The Board would note that the adoption of the grandfathering criteria was in direct correlation to the

adoption of the Stipulation of Settlement. Therefore, the Board considers the arguments of Enserch which pertain to alleged violations of the Administrative Procedure Act to be similar to those previously made in a Motion for a Stay and for Reconsideration of the Board's Decision and Order Adopting the Stipulation of Settlement filed by the Clean Coal Developers. In its Order denying said Motion issued on October 19, 1988, the Board stated, in pertinent part:

> There can be no doubt that the record in the Board's consideration of cogeneration and small power production is extensive. This proceeding was initiated in October 1980, and lengthy hearings were held at the Board wherein a full record was developed.
>
> The culmination of this effort was a Board Decision and Order issued on October 14, 1981, wherein procedures and policies affecting the development of cogeneration and small power production in New Jersey were established. The Board further directed that within five years therefrom, a review of cogeneration and small power production would be commenced. Said review was initiated in a timely manner and additional hearings were held before the Board on September 9 and 11, 1987.
>
> It is clear, therefore, that the consideration of cogeneration and small power production policies in New Jersey is and has been a formal ongoing proceeding before the Board under one caption and one docket number. In addition, the consideration of those policies set out in the Decision and Order of October 14, 1981 was necessary in order for the board to ultimately rule on the appropriateness and reasonableness

of modification affecting the development of cogeneration and small power production in New Jersey.

Therefore, for substantially the same reasons that we rejected the arguments of the Clean Coal Developers, the Board rejects the claim of Enserch that the Board erred in promulgating its criteria for determining which projects are to be grandfathered.

With respect to the application for reconsideration which is now before us, and based upon our review and consideration of all submissions in this matter, it is the opinion of the Board that the development of the Freehold Project could potentially provide long term benefits to the ratepayers of JCP&L. This project could provide JCP&L with an efficient source of energy and capacity that may offset or delay the need for the utility to build additional generation or transmission facilities. Such results would assist JCP&L by allowing it to continue to provide safe, adequate and proper service to its ratepayers in an area that has experienced substantial load growth in the recent past. The Board is of the further opinion that grandfathering, as opposed to the bidding process now in place, appears to be consistent with the timely development of the Freehold Project.

It is the further opinion of the Board that while negotiations had not resulted in a firm pricing agreement, the submissions before us indicate that the parties had reached a pricing agreement in principle, and despite some uncertainties therein, we believe that understanding to be sufficient base upon which to support a determination that grandfathered status should be approved.

As stated in our September 28, 1988 order and restated hereinabove, applications from cogeneration and

small power production projects seeking grandfathered status will be reviewed and considered on a case by case basis taking into account the specific facts presented therein. The Board's final decision must balance the ratepayers' interest in receiving safe, adequate and proper service with their interest in the setting of just and reasonable rates for that service.

After full review and consideration, the Board finds that the facts specific to this matter warrant the approval of grandfathered status to the Freehold Project. In taking into account the interests of the parties and the ratepayers and in recognizing the uncertainties in the pricing agreement, the Board also finds that any pricing arrangement and results from further negotiations will be assessed against the current level of JCP&L's forecast of its avoided cost as delineated in its Request for Proposals, which was approved by the Board on May 10, 1989. We believe that such treatment will result in a fair level of costs to be borne by the ratepayers while permitting an opportunity for the timely development of the project and the realization of project benefits to the ratepayers. This pricing approach is consistent with the Board policy in effect prior to the adoption of the Stipulation of Settlement regarding the appropriate payments to be made to those projects that wished to receive the benefits which are inherent in a levelized pricing structure. As indicated hereinabove, the Board recognizes the potential benefits of the Freehold Project, including those related to meeting the capacity needs of JCP&L. In order that these potential benefits may be realized, both parties are encouraged to negotiate to reasonable settlement on the issue of pricing subject to the parameters set out above. The Board will support such negotiations and will be receptive to any resulting agreement that will provide an opportunity for the project to succeed.

Accordingly, the Motion for Reconsideration and the Supplemental Motion for Reconsideration are granted to the

extent that grandfathered status, subject to the terms set out hereinabove, is approved for the Enserch Freehold Project. Based upon the foregoing, the Board considers the motion of Enserch to compel JCP&L to continue negotiations to be moot.

DATED: July 31, 1989 BOARD OF PUBLIC UTILITIES
BY: /s/

CHRISTINE TODD WHITMAN
PRESIDENT

/s/
GEORGE H. BARBOUR
COMMISSIONER

ATTEST:

/s/
KAREN KENNEDY

# APPENDIX B

JCP&L GPU
Daniel V. Gulino
Attorney

Jersey Central Power & Light Company
300 Madison Avenue
Morristown, N.J. 07892
(201) 488-3404

March 31, 1992

Chrys Wilson, Secretary
Board of Regulatory Commissioners
44 South Clinton Avenue
CN 350
Trenton, New Jersey 08625

Re: Application of Jersey Central Power & Light Company for Approval of the Power Purchase Agreement Between Jersey Central Power & Light Company and Freehold Cogeneration Associates, L.P.

Dear Ms. Wilson:

Pursuant to the Board's Orders dated October 14, 1981 and December 7, 1983 entered in Docket No. 8010-687, entitled "In the Matter of the Consideration and Determination of Cogeneration and small Power Production Standards Pursuant to the Public Utility Regulatory Policies Act of 1978" ("PURPA"), Jersey Central Power & Light Company ("JCP&L") submits for filing and approval the Power Purchase Agreement, dated March 24, 1992, (the "Agreement") between JCP&L and Freehold Cogeneration Associates, L.P. ("Freehold").

JCP&L respectively requests that the Board review the terms of the Agreement, find and determine that the Agreement is in the public interest and in accordance with the law, and that the costs to be incurred by JCP&L with respect thereto are prudently incurred. In support of this application, JCP&L respectfully states:

I

Freehold is a New Jersey limited partnership whose general partners are Advanced Power Systems, Inc. of St. Charles, Maryland and Constellation Energy, Inc. of Baltimore, an affiliate of Baltimore Gas & Electric Company. Freehold proposes to own, operate and maintain at a site adjacent to the Nestle Beverages Company facility in Freehold, New Jersey, a cogeneration facility having a nameplate capacity of approximately 112 megawatts for the purpose of generating electricity and producing steam[1] for the Nestle facility.

Freehold will own and operate the facility as a PURPA qualifying cogeneration facility ("QF") using natural gas as the primary energy source, but will also have the ability to use a secondary energy source such as oil. Heat will be extracted from the facility and used to produce steam for the adjacent Nestle facility. The Agreement provides that 100 megawatts (92°F) of the capacity and electrical energy of the facility will be sold to and will be under the dispatch control of JCP&L.

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1 The Thermal Sales Agreement between the Seller and Nestle contains confidential and proprietary information. At the request of the parties to that agreement, JCP&L is not submitting a copy of the Thermal Sales Agreement with this application. Moreover, upon the request of the Board, the Seller will submit the Thermal Sales Agreement after receipt of a Protective Order from the Board.

II

In its order entitled "Order Regarding Motion for Reconsideration of Denial of Grandfather Status", dated July 31, 1989 (the "Order"), the Board grandfathered the Project from the Stipulation of Settlement (BPU Docket No. 8010-687B) which requires, among other things, that the State's electric utilities competitively bid all non-utility generation capacity. In its Order, the Board directed "that any pricing arrangement that results from further negotiation will be assessed against the current level of JCP&L's forecast of its avoided costs as delineated in its Request for Proposals, which was approval by the Board on May 10, 1989". Accordingly, pursuant to the Board's Order, the total Project payments are equal to JCP&L's 1989 Avoided Costs.

Pursuant to the Agreement, the Variable Energy Payment will be made to Freehold for each kilo-watt hour generated and sold to JCP&L during a scheduled Dispatch Period and associated start-up and shut-down periods. The Variable Energy Rate is established at 2.20¢ per kWH in 1995, and will be escalated 7% per year on each January 1 commencing with January 1, 1996. Based on these dispatch rates, it is expected that the facility will be economically dispatched for about 7000 hours/year. With an average annual availability of 94%, the capacity factor for the facility should be approximately 75%. The Fixed Payment component of the Project pricing will commence on the Commercial Operation Date and will increase on each anniversary of the Commercial Operation Date by a predetermined amount. Freehold will be entitled to receive the full Fixed Payment only if the annual Contract Availability remains at or above 94%. If the Contract Availability falls below 94%, the Fixed Payment is reduced proportionately.

Finally, the term of the Agreement is for twenty (20) years commencing on the Commercial Operation Date, which occurs 48 months after the month in which regulatory approval of the Agreements is obtained. Furthermore, the Agreement also provides for a Suspense Account should the Seller elect to front-end load payments. As provided in the Agreement, Freehold must propose the percentage of and number of years during which Fixed Payments are to be front-end loaded. The Agreement, however, limits the front-end loading duration to twenty years and the front-end loading percentage to 65% consistent with JCP&L's prior power purchase agreements.

III

State utility commissioners are vested with the responsibility of assuring that the jurisdictional utilities act in the public interest in their contractual arrangements. This fundamental tenet of regulatory law has given rise to the question of whether this Board or its successor might at some point in the future try to exercise jurisdiction over this Agreement or refuse to permit JCP&L to flow through to, and/or fully and timely recover from its ratepayers the rates specified in the Agreement over the full term thereof.

Principles of equity dictate that the Board provides both the purchasing utility and the cogenerator with sufficient assurances that the avoided costs contract rate, once approved by the Board will not be subject to further scrutiny. In this regard, FERC has indicated that neither the purchasing utility not the QF are to be deprived of the mutual benefits of entering into a long-term contract based on Board approved avoided cost rates. In order to preserve the benefit of the bargain between the utility and the QF, flow-through of the purchased power costs incurred under this or similar agreements must be assured.

In the instant case, both JCP&L and Freehold need to have the certainty that neither this nor future Boards will impair the utility's right to flow-through to and/or fully and timely recover from its ratepayers the contracted for, and Board-approved, purchase price over the full term of the Agreement or exercise jurisdiction over this or similar agreements.

Based upon the foregoing, JCP&L respectfully requests that the Board:

(1) approve the terms of the Agreement;

(2) find and determine that the Agreement is in the public interest and in accordance with the law; and

(3) find and determine that the costs to be paid by JCP&L under the Agreement are prudently incurred and may appropriately be recovered in rates through the levelized energy adjustment charge or otherwise.

Respectfully Submitted,
JERSEY CENTRAL POWER & LIGHT COMPANY

/s/
Daniel V. Gulino
Its Attorney
300 Madison Avenue
Morristown, New Jersey 07962

# APPENDIX C

AGENDA DATE: 6/9/92

**STATE OF NEW JERSEY**
**Board of Regulatory Commissioners**
**Two Gateway Center**
**Newark, NJ 07102**

| | | |
|---|---|---|
| APPLICATION OF JERSEY CENTRAL POWER & LIGHT COMPANY FOR APPROVAL OF THE POWER PURCHASE AGREEMENT BETWEEN JERSEY CENTRAL POWER & LIGHT COMPANY AND FREEHOLD COGENERATION ASSOCIATES, L.P. | ) | ORDER OF APPROVAL |
| | ) | DOCKET NO. EM9203059 |

(Service List Attached)

BY THE BOARD:

By letter dated March 31, 1992, Jersey Central Power & Light Company (JCP&L petitioned the Board of Regulatory Commissioners (Board) for approval of the proposed agreement (Agreement) for the purchase of electric power from Freehold Cogeneration Associates, L.P. (Freehold).

Freehold is a New Jersey limited partnership whose general partners are Advanced Power Systems, Inc. and Constellation Energy, Inc., an affiliate of Baltimore Gas & Electric Company, which proposes to own, operate and maintain a cogeneration facility (Facility) at the Nestle Beverages Company plant (Nestle) in Freehold, New Jersey. The Facility will be approximately 112 megawatts (MW) in size and will be a Public Utilities Regulatory Policies Act (PURPA) qualifying facility (QF) under Federal Energy Regulatory Commission guidelines. The Agreement provides

for Freehold to deliver 100 MW to JCP&L and steam and possibly native loan electricity to Nestle.

The Facility will use natural gas of regulatory approval and continues for 20 years from the commercial operation date, which is anticipated to be 48 months after the date of regulatory approval. The commercial operation date may be extended due to force majeure without penalty, and for up to three years by making payments into a liquidated damages fund.

The Freehold/Nestle project is grandfathered under the policies and procedures in effect prior to the current competitive bidding procedures. The Facility was grandfathered in an Order issued on July 31, 1989, in Docket No. 8010-687B. The conditions set forth in the Board's grandfathering Order set a cap on the pricing based on the avoided costs contained in JCP&L's first round of competitive bid Requests for Proposals (RFPs) approved by the Board on June 6, 1989.

The terms and conditions in the Agreement are similar to or superior, from a ratepayer perspective, to those contained in the bid contracts and as established in the Stipulation of Settlement (Stipulation) in Docket No. 8010-687B. Subject to certain technical and contractual limits, JCP&L shall have complete dispatching control of the Facility.

The price in the Agreement is equal to the June 6, 1989 avoided cost. The payment to Freehold is comprised of a variable energy rate of 2.2 cents per kilowatt-hour escalated at 7% per year and a fixed capacity payment which produces a total payment equal to the avoided cost.

Since the variable energy rate in this contract has a fixed escalation rate of 7%, the Board believes a comparable fuel contract is essential to protect electric ratepayers from the possibility that the project would not be financially viable in the future if its actual fuel price escalations significantly exceed 7%. A letter of intent between NJNG and Freehold was reviewed by Board Staff and Staff has indicated to the Board that it is satisfied that its

terms and conditions will allow for the project to be viable over its term.

There is a suspense account provision which requires Freehold to secure 100% of any levelization incurred by the project. Freehold can choose the levelization it requires for financing, between 0 and 65% for a period of up to 20 years. This suspense account exceeds the ratepayer protection incorporated in the Stipulation of Settlement since the competitive bidding guidelines require security only if levelization exceeds 120% of avoided cost for gas projects and the Agreement requires the full amount of the surplus account to be secured with a letter of credit.

The expected capacity factor of the facility is 75% with an average availability of 94%. The fixed payment will be reduced if the facility's annual availability factor falls below 94%. To determine the fixed payment the annual availability multiplier is equal to the lesser of one (1.00) and the quotient obtained by dividing the contract availability by ninety-four one-hundredths (.94). This accounts for outages whether maintenance, forced or force majeure.

In addition, by letter dated April 13, 1992, Freehold requested that the Board find the Facility, which will supply steam to Nestle and electric energy to JCP&L, is not a public utility subject to the jurisdiction of the Board.

The Facility is a qualifying facility (QF) pursuant to Federal Energy Regulatory Commission regulations applicable to cogenerators. The Board has on several occasions previously addressed the issue of whether the sale of steam or electricity from a QF to its thermal host will subject the cogenerator to Board jurisdiction. In its Order in In the Matter of the Petition for Approval of Power Purchase Agreement between Atlantic City Electric Company and Chambers Cogeneration Limited Partnership, Docket NO. EM88111219 (March 31, 1989), where the Board stated as follows:

> Petitioners have also requested that the Board find that the sale by Chambers to Dupont of steam and a

portion of the electrical output of the facility will not result in Chambers being deemed a public utility subject to the jurisdiction of the Board. Chambers, a third party developer, proposes to develop the cogeneration facility on property owned by Dupont and intends to sell thermal and electrical energy and capacity to Dupont with all excess electrical energy and capacity being sold to Atlantic Electric. In instances such as this, where the developer provides thermal and electrical energy and capacity only to the host with all of the excess electrical energy and capacity being sold to a public utility, the Board does not believe that the sale of thermal or electrical energy and capacity to the host should subject the third party developer or its affiliates to the jurisdiction of the Board. Therefore, the Board HEREBY DETERMINES that the sale by Chambers to Dupont of steam and a portion of the electrical output of the facility will not result in Chambers Cogeneration Limited Partnership or any of its individual general or limited partners or their parents or affiliates being deemed a public utility subject to the jurisdiction of the Board.

Freehold requested that the same finding be provided for its Facility. The Facility will sell 100 MW of capacity and energy to JCP&L and will supply steam and possibly native load electricity to Nestle. Its sole steam host will be Nestle.

Board Staff has reviewed a copy of a site plant for the Facility, showing the boundaries for the Facility site and the Nestle property, the location of the Facility and the location of the Nestle plant. The Facility will be located

on land immediately adjacent to the Nestle plant that is owned by Nestle. The steam lines used to deliver steam to Nestle will not cross a public way.

Based upon its review of the location and ownership of the Freehold facilities and their relationship to the industrial host, the Board believes that the proposed Freehold facility meets the standards espoused in the Board's Chambers Order. On that basis the Board concurs that the sale of steam or electricity from the facility by Freehold to Nestle would not subject the developer or its affiliates to the jurisdiction of the Board under present policy.

The Board has reviewed the Order grandfathering the Facility and the conditions established therein and finds that the Agreement meets or exceeds the requirements for approval. The price is equal to 100% of the applicable avoided cost and the contract terms and conditions from the Stipulation were met or exceeded. The long term gas contract when signed will provide a stable fuel supply which will assist in assuring ratepayers that the project will be in a position to produce electricity economically for the term of the Agreement. The Board FINDS that the Agreement is consistent with the grandfathering Order.

Based on the above, the Board FINDS the Agreement to be fair and reasonable and that it will impart substantial benefits to JCP&L's ratepayers over the life of the project.

Accordingly, the Board, having reviewed the Agreement and being satisfied that it is in the public interest and in accordance with applicable law, the aforementioned Board Orders as entered in Docket Nos. 8010-687 and 8010-687B, and the Stipulation of Settlement, HEREBY APPROVES the Power Purchase Agreement between Jersey Central Power & Light Company and Freehold Cogeneration Associates, Inc., dated as of March 26, 1992, and as such finds the rates specified therein and the costs resulting therefrom to be reasonable and reasonably and prudently incurred by JCP&L throughout the full term of the Agreement. Therefore, the Board and its successors will allow JCP&L to flow-through and/or fully and timely recover

the rates specified in the Agreement and the costs resulting thereform in the manner set forth in the Board's Order dated September 28, 1988 (Docket No. 8010-687B) and the July 1, 1988 Stipulation of Settlement adopted thereby, and as clarified in the Board's Order dated October 2, 1990 in Docket No. EM88050655.

In addition, the Board having reviewed the possible sale of thermal and electric energy by Freehold to Nestle, its industrial host, HEREBY DETERMINES that the sale by Freehold to Nestle of steam and a portion of the electric output of the facility will not result in Freehold or any of its partners, parents or affiliates being deemed a public utility subject to the jurisdiction of the Board.

DATED: JULY 8, 1992

BOARD OF REGULATORY COMMISSIONERS

BY:

/s/
DR. EDWARD H. SALMON
CHAIRMAN

/s/
JEREMIAH F. O'CONNOR
COMMISSIONER

/s/
CARMEN J. ARMENTI
COMMISSIONER

ATTEST:

/s/
IRENE JOHNSON
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utility commissioners

/s/
Chrys Wilson
Secretary

## SERVICE LIST

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Newark, NJ 07109

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utility commissioners

/s/
Chrys Wilson
Secretary

# APPENDIX D

AGENDA DATE: 11/24/93

**State of New Jersey**
**Board of Regulatory Commissioners**
**CN 350**
**Trenton, NJ 08625-0350**

| | | |
|---|---|---|
| APPLICATION OF JERSEY CENTRAL POWER & LIGHT COMPANY FOR APPROVAL OF THE POWER PURCHASE AGREEMENT BETWEEN JERSEY CENTRAL POWER & LIGHT COMPANY AND FREEHOLD COGENERATION ASSOCIATES, L.P. | ) | ELECTRIC |
| AND | ) | ORDER OF DENIAL |
| VERIFIED PETITION OF FREEHOLD COGENERATION ASSOCIATES, L.P., FOR APPROVAL OF JOINT AGREEMENT BETWEEN BOARD OF REGULATORY COMMISSIONERS STAFF & FREEHOLD COGENERATION ASSOCIATES, L.P. | ) | DOCKET NO. EM92030359 |

(Service List Attached)

BY THE BOARD:

By letter dated November 3, 1993, Freehold Cogeneration Associates, L.P., ("FCA") petitioned the Board of Regulatory Commissioners ("Board") for approval of a Joint Agreement between the staff of the Board ("Staff") and FCA recommending certain proposed modifications to the

Power Purchase Agreement ("Agreement between Jersey Central Power and Light Company ("JCP&L" or "Company") and FCA previously approved by the Board by Order dated July 8, 1992.

FCA is a New Jersey limited partnership whose general partners are Advanced Power Systems, Inc. and Constellation Energy Inc., an affiliate of Baltimore Gas & Electric Company, which proposes to own, operate and maintain a 110 megawatt (MW) cogeneration facility ("Facility") at the Nestle Beverages Company plant ("Nestle") in Freehold, New Jersey. The Facility will be a Public Utilities Regulatory Policies Act ("PURPA") qualifying facility ("QF") under Federal Energy Regulatory Commission guidelines. The Agreement provides for FCA to deliver 100 MW of electric capacity and associated energy to JCP&L, and steam and possibly native load electricity to Nestle.

The Facility will use natural gas as a primary fuel with fuel oil as the probable backup fuel. The Facility will be a combined cycle facility using a combustion turbine, a heat recover steam generator and a steam turbine.

The Agreement begins on the date of regulatory approval and continues for 20 years from the commercial operation date, which is anticipated to be 48 months after the date of regulatory approval. The commercial operation date may be extended due to force majeure events without penalty, and for up to three years by making payments into a liquidated damages fund.

**Background:**

In early 1988, pursuant to the then-effective cogeneration policies of the Board of Public Utilities ("BPU"), predecessor agency to the Board, Enserch Development Corporation and its partner, Turner Power

Corporation, the original developers of the project, commenced negotiations on a power purchase agreement with JCP&L. During the pendency of those negotiations, the BPU adopted its competitive bidding guidelines (BPU Docket No. 8010-687B, Order dated September 28, 1988). Competitive bidding effectively replacing negotiations as the means of procuring long-term electric capacity and energy power purchase agreements with non-utility generators.

Concurrent with the adoption of its competitive bidding guidelines, the Board approved a list of projects that were grandfathered from competitive bidding. (Docket No. 8010-687B, Order dated September 28, 1988) The grandfathered cogeneration projects had all reached an agreement on price with the utility, and were permitted to finalize power purchase agreements without being required to go through a competitive bid process.

FCA was not on the original list of projects grandfathered by the BPU. FCA therefore filed a Motion for Reconsideration asking the BPU to reconsider its decision to not grandfather the project. The BPU subsequently issued an Order grandfathering the project or reconsideration. In grandfathering the project from competitive bidding, however, the BPU determined that the project's pricing should not exceed an avoided cost cap used by JCP&L in its 1989 RFP. (Docket No. 8010-687B, Order dated July 31, 1989)

Subsequent to the FCA project being grandfathered, FCA and JCP&L spent over two years negotiating a power purchase agreement. A power purchase agreement was ultimately agreed to and submitted to the Board for approval on March 31, 1992. By written Order dated July 8, 1992, the Agreement was approved by the Board. The pricing in the agreement was equal to the maximum level ordered by the Board in its grandfathering order, which is the price cap used in JCP&L's 1989 RFP.

Since the Board's original grandfathering Order and subsequent approval of the FCA Agreement, two significant events have occurred. The first is that avoided costs have dropped significantly. Second, Public Service Electric & Gas Company (PSE&G) and Towner Electric I, L.P. ("Towner Electric") negotiated buy-out of a power purchase agreement in late 1992. In the Matter of the Joint Petition of Public Service Electric and Gas Company a Towner Electric I. L.P. for Approval of a Second Amendment to Power Purchase and Interconnection Agreement. Decision and Order, Docket No. EM91040844, ("Towner"). The Towner Electric contract pricing exceeded forecasts of PSE&G's avoided costs by over $500 million of a net present value (NPV) basis for the 440 MW project; PSE&G, however, was able to terminate the contract for a buy-out payment of $18.5 million.

The Towner case brought to the forefront the concept of buying out contracts which are no longer beneficial based upon changed circumstances. The Board in its Order approving the Towne Electric buy-out, directed the other electric utilities under its jurisdiction to:

> "assess existing contracts with particular emphasis on those projects in the earliest stages of development to determine whether or not they remain economic and whether there are any candidates for exploring buy-outs or other remedial measures"; and to report back to the Board staff.

Consistent with that order, JCP&L reported to Staff that the FCA Agreement exceeded JCP&L's September 1991 avoided costs by $190 million NPV and that the project was in the early stages of development. JCP&L subsequently initiated buy-out talks with the project. Those overtures were rejected by the project.

As a result of the positions taken by JCP&L and FCA, it was clear to Staff that no agreement was going to be mutually reached between FCA and JCP&L. Staff therefore pursued directly with FCA mitigation of the Towner concerns raised by the Board and identified by JCP&L. In recognition of the apparent economic development benefits of the planned cogeneration project for the steam host (Nestle Foods) and the Township of Freehold, as well as the economic activity related to the construction and operation of the cogeneration facility and the substantial benefits for gas ratepayers attendant to the proposed gas supply contract, Staff explored price concessions directly with FCA as an alternative to a project buyout. Staff and FCA ultimately reached an agreement on price concessions intended to meet the concerns raised by the Board in its Towner Order.

These concessions were memorialized in a Joint Agreement between Staff and FCA which was filed with the Board on November 3, 1993 for its approval. At its November 10, 1993 agenda meeting, the Board formally set a schedule for written comments on the Joint Agreement as well as on the modified gas service agreement between FCA and New Jersey Natural Gas Company, which was filed on November 23, 1992 (Docket No. GM92111058). Comments and/or replies thereto were received from JCP&L, the Department of the Public Advocate-Division of Rate Counsel ("Rate Counsel"), New Jersey Natural Gas Company ("NJNG"), V.O.I.C.E., and Board Staff.

**The Joint Agreement:**

The Joint Agreement contains certain proposed pricing concessions by FCA. The Joint Agreement recommends that the Board in its Decision and Order approving the Joint Agreement, recommended to JCP&L that FCA and JCP&L enter into an amendment to the Agreement whereby FCA will agree to effectively lower its rates and provide other incremental benefits as set forth in the Joint Agreement in exchange for certain non-financial modifications to the Agreement.

The proposed pricing concessions included in the Joint Agreement are as follows:

(a) FCA will provide an additional 10 MW to JCP&L with no additional capacity charges and the energy priced the same as in the Agreement.

(b) FCA will lower its variable energy rate from 3.302 cents per kwh to 3.271 cents per kwh effective February 1, 2001. After January 1, 2002, the variable energy rate will escalate at 6% per year as opposed to 7% per year.

(c) The capacity payments to FCA will be reduced by $10 million per year for each of the last three years of the Agreement.

(d) FCA agrees not to sell electricity directly to either Nestle or to Interstate Waste Technologies which is developing a sludge to methanol project on an adjacent site.

FCA requested that the Board approve the Joint Agreement and find and determine that the Joint Agreement and the modifications to the power purchase agreement address all concerns about possible contract renegotiation

and/or buyout of the Agreement raised by the Board in its Towner Order and by JCP&L in its response to that Order.

**Summary of Comments:**

FCA argues for approval of the Joint Agreement. FCA states that it was willing to live with the terms of the original Agreement. It did not seek any modifications to the original Agreement. It has offered price concessions in an attempt to meet the Board's concerns raised in the Towner Order, not in exchange for other non-price concessions. FCA values the price concessions at approximately $50 million net present value (NPV). FCA believes the Staff, in negotiating and signing the Joint Agreement, was appropriately exercising its role of insuring that Board's policies are properly implemented.

JCP&L opposes approval of the Joint Agreement. As an alternative, JCP&L urges that the Board require FCA to demonstrate that the project is viable under current avoided costs. If FCA fails to so demonstrate, JCP&L believes the Board should require FCA to enter into negotiations with JCP&L for (a) an appropriate buy-out of the project or (b) an amendment to revise the pricing to be consistent with current avoided costs. If no agreement between JCP&L and FCA is reached within 90 days, JCP&L believes the Board should commence a proceeding to determine if the Order approving the power purchase agreement should be modified or revoked, or, in the alternative, to disallow recovery from JCP&L's customers of such portion of the costs thereunder which are found to be substantially in excess of JCP&L's current avoided costs.

In April and September of 1993, JCP&L made buy-out offers to FCA. In response to JCP&L's September offer, FCA stated that in settlement discussions with Staff had resulted in considerable progress and it was therefore inappropriate to discuss buy-out with JCP&L. JCP&L

alleges that FCA's discussions with Staff removed are incentive on FCA's part to engage in meaningful buy-out or price reduction negotiations with JCP&L.

JCP&L argues that its due process rights have been violated because of the expedited comment period established by the Board. JCP&L received the petition for approval of the Joint Agreement on November 5, 1993. On November 9, 1993, JCP&L filed a letter stating that the proposed schedule for consideration of this matter was too ambitious. Further, JCP&L requests hearings on the many factual issues which it alleges require consideration. Finally, JCP&L objects to Staff acting in an advisory capacity in this matter since it is essentially a party to a contested agreement.

JCP&L argues that the Board should not modify the terms of a freely negotiated agreement between itself and the project at the request of one party. JCP&L concedes that the Joint Agreement includes some price reductions, but contends that the purported savings are approximately $17 million NPV as opposed to the $50 million NPV estimated by FCA. Additionally, JCP&L strongly opposes the changes to other contract terms requested by FCA in exchange for the pricing concessions. Specifically, JCP&L does not believe the price concessions address the economic concerns raised in the Board's Towner Order. Therefore, it does not believe FCA should be relieved of "regulatory risks" as requested. Also, JCP&L claims that FCA is now asking to modify terms concerning assignment that JCP&L has previously refused to modify.

JCP&L contends that the proposed modified price agreement exceeds current avoided costs by approximately $1.1 billion over in term, or $350 million NPV. JCP&L does not believe the Board should take any actions which would enhance the viability of this project or relieve it of its obligations under the Board's Towner Order.

Rate Counsel urges the Board to deny the relief requested in the petition and to order the parties to renegotiate based upon current avoided costs. Further, Rate Counsel argues that the Administrative Procedures Act requires that the Board conduct evidentiary hearings prior to making a determination regarding this matter.

Rate Counsel concurs with JCP&L that even with the proposed amendments the agreement is uneconomical and will continue to impose an egregiously heavy burden on JCP&L ratepayers. Rate Counsel believes this is contrary to the Board's Towner Order, wherein the Board directed utilities to review their existing contracts to determine whether or not these contracts remain economic and explore measures that could be taken to remedy any uneconomical contract.

NJNG believes that the Board should approve both the modified gas service agreement (GSA) and the Joint Agreement between Staff and FCA. In essence, NJNG argues for approval of the Joint Agreement based on its belief that it will provide economic and environmental benefits in addition to the benefits to the customer of NJNG.

By letter dated November 15, 1993, V.O.I.C.E., an unincorporated association of residents of Freehold Township, submitted comments on the Joint Agreement and to support a Motion to Intervene. V.O.I.C.E. believes FCA is required to receive a Certificate of Need prior to constructing the facility. V.O.I.C.E. disputes many of the alleged benefits identified in FCA's petition and argues that the modified agreement is not in the best interest of ratepayers.

By letter dated November 19, 1993, FCA responded in opposition to V.O.I.C.E.'s motion. FCA contends that the V.O.I.C.E. motion:

1) fails to identify what interest, if any the V.O.I.C.E. members have in this proceeding, and

2) fails to identify how those interests are different from those represented by Rate Counsel.

FCA also argued that V.O.I.C.E.'s substantive arguments lack merit. FCA refutes V.O.I.C.E.'s argument that the FCA facility is a public utility which must obtain a Certificate of Need prior to constructing its facility.

FCA argues that the proposed facility is not a public utility, rather it is a non-utility generator which is exempt from state regulation under federal law (PURPA) and is exempt from the requirement of filing for a Certificate of Need.

With regard to the Motion to Intervene, V.O.I.C.E. has not demonstrated a direct interest in this proceeding under N.J.A.C. 1;1-16.1(a), nor has it demonstrated whether any such interest is different from that which is represented by Rate Counsel. We concur with FCA that the proposed facility is not a public utility and is therefore exempt from the requirement of filing for a Certificate of Need. Accordingly, the Motion to Intervene of V.O.I.C.E. is HEREBY DENIED.

**Discussion:**

Both JCP&L and Rate Counsel indicate in their comments that they were excluded from the negotiations between Staff and FCA. JCP&L, in particular, strongly criticizes the actions of Staff in this matter. Before moving to the substance of the Joint Agreement the Board will briefly address this issue.

In its response to comments, Staff explains its role in the process from the time of the filing of JCP&L's Towner response through the filing of the petition and Joint Agreement with the Board in early November. It is clear to the Board that Staff acted entirely in good faith in this matter. Contrary to the accusations of JCP&L, it appears that Staff kept the Company fully informed of the status and content of the discussions. Staff is correct in its assessment that JCP&L has limited unilateral ability to demand contract pricing concessions, to the extent that FCA is meeting all of its contractual commitments. Staff undertook a legitimate attempt to address the concerns raised in the Board's Towner Order and JCP&L's response thereto, and to procure more reasonable rates for JCP&L and its ratepayers. Rather than launching an inappropriate attack on Staff, JCP&L should have lauded the effort by Staff to attempt to reach a negotiated resolution of this issue which would have the effect of reducing rates to its customers. In the strongest possible terms, the Board rejects the unfounded attacks on Staff and other assertions that due process rights were violated.

We concur with JCP&L and Rate Counsel however, that while the Joint Agreement provides price concessions by FCA relative to the original Agreement, which somewhat improve the economics of the transaction, the revised pricing terms are still far in excess of current avoided cost forecasts. It is estimated by JCP&L that the original agreement exceeds current avoided costs by $1.215 billion, while the proposed modified agreement exceeds current avoided costs by $1.145 billion (or $370 million and $350 million NPV, respectively). Absent any further modifications, it is apparent to us that JCP&L's customers will most likely be saddled with these excessive costs for the next twenty years, were the project to proceed.

As indicated above, the Joint Agreement leaves the pricing in the Power Purchase Agreement significantly above current forecasts of avoided cost. As such, the Board does not believe it represents a reasonable resolution of this matter consistent with the concerns raised in the Board's recent Towner decision. Therefore, the Board REJECTS the Joint Agreement. The Board HEREBY ORDERS JCP&L and FCA to enter into immediate good faith negotiations to develop modifications to the Agreement to bring it more in line with current avoided costs, or, in the alternative for an appropriate buy-out of the Agreement, subject to the Board's approval. If no agreement between FCA and JCP&L is reached and submitted to the Board within thirty days of the date of this Order the Board will commence an evidentiary proceeding, pursuant to N.J.S.A. 48:2-40, to consider what actions, if any, should be taken by the Board, including modification or revocation of its Order approving the Agreement.

We would note that information has been introduced into this record which indicates that there would be substantial economical benefits for both Freehold Township and Nestle from the development of the FCA project. Specifically, Freehold Township would receive over $6 million in direct benefits, including an upgrade to its water and sewer system plus contributions to various civic projects Nestle would receive site lease benefits and energy discounts estimated to be worth $2 million per year. We therefore urge the parties to include in their discussion mechanisms which would preserve the benefits to Nestle and the Township which have been anticipated in reliance upon the development of this project.

The substantial magnitude of the apparent economic disbenefit associated with the existing Agreement combined with the fact that the project is in the relatively early stages of development warrants our deep concern and resultant

directive to the parties to negotiate modifications to the Agreement or a buy-out, consistent with the Board's regulatory oversight obligations. If the parties work together, we are hopeful that significant savings to ratepayers can be achieved while maintaining the benefits for Freehold Township and Nestle and at the same time allowing FCA to continue with the project with prices more consistent with current avoided costs or, in the alternative, working out an appropriate project termination which leaves all parties whole. Thus, the Board is giving the parties an opportunity to try to craft such an agreement in a manner which is least disadvantageous to all parties. However, the Board is putting JCP&L and FCA on notice that if they cannot reach agreement on either reasonable renegotiated pricing terms more consistent with current avoided costs or a buy-out arrangement within 30 days, the Board is prepared to commence a proceeding to consider whether its previous approval of this Agreement should be modified or otherwise reconsidered or revoked.

Finally, the Board does not believe it is appropriate to make a determination concerning the gas service agreement until such time as the issues concerning the power purchase agreement have been resolved. On that basis, the Board will defer action on the gas service agreement until the issues

concerning the power purchase agreement have been resolved.

DATED: January 5, 1994

BOARD OF REGULATORY COMMISSIONERS BY:

/s/

DR. EDWARD H. SALMON
CHAIRMAN

/s/

JEREMIAH F. O'CONNOR
COMMISSIONER

/s/

CARMEN J. ARMENTI
COMMISSIONER

ATTEST:

/s/

IRENE JOHNSON
SECRETARY

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# APPENDIX E

**AGENDA DATE: 2/18/94**
**3/4/94**

**State of New Jersey**
**Board of Regulatory Commissioners**
CN 350
Trenton, NJ 08625-0350

| | | |
|---|---|---|
| APPLICATION OF JERSEY CENTRAL POWER & LIGHT COMPANY FOR APPROVAL OF THE POWER PURCHASE AGREEMENT BETWEEN JERSEY CENTRAL POWER & LIGHT COMPANY AND FREEHOLD COGENERATION | ) | ELECTRIC ORDER DENYING STAY AND ESTABLISHING PROCEDURAL SCHEDULE |
| AND | ) | |
| VERIFIED PETITION OF FREEHOLD COGENERATION ASSOCIATES, L.P., FOR APPROVAL OF A JOINT AGREEMENT BETWEEN BOARD OF REGULATORY COMMISSIONERS STAFF & FREEHOLD COGENERATION ASSOCIATES, L.P. | ) | DOCKET NO. EM92030359 |

(SERVICE LIST ATTACHED)

BY THE BOARD:

This matter is before us for consideration of further procedures consistent with our January 5, 1994 Order of Denial in the above matter. In that Order, the Board rejected a Joint Agreement between Freehold Cogeneration Associates, L.P. (Freehold) and the Board's Staff for certain modifications of the Power Purchase Agreement (Agreement

or PPA) between Freehold and Jersey Central Power and Light Company (JCP&L) because we found that, even with the proposed modifications, the Agreement remains far in excess of current avoided cost forecasts and is not otherwise beneficial to ratepayers. We further ordered that Freehold and JCP&L enter into good faith negotiations to attempt to reach agreement on a modification of the purchase rates contained in the PPA or an appropriate buyout of the Agreement. We further indicated that if these negotiations were not successful within 30 days, the Board would commence a proceeding and hold hearings to consider what, if any, further action we can and should take, including possible reconsideration, modification or revocation of our July 1992 Order in the above matter, wherein we approved the Agreement and granted ratemaking approval of the pass-through of the costs associated with the Agreement to JCP&L's customers.

While Freehold and JCP&L did undertake some limited negotiations, they were not able to reach agreement on a modification of the Agreement or a buyout within the 30-day timeframe. The Board was so advised by a letter from JCP&L dated February 3, 1994. In its letter, JCP&L requested that the Board commence a proceeding as set forth in its January 5, 1994 Order and transmit the matter to the Office of Administrative Law (OAL) for hearings.

By letter dated February 10, 1994, Freehold responded to JCP&L's letter and, pursuant to N.J.A.C. 14:1-8.7, requested a stay of the proceedings referred to in the Board's January 5, 1994 Order and the hearing requested by JCP&L in its letter. While Freehold asserts that the parties should be given more time to negotiate, the basis of its request for a stay is to allow the federal court to rule on its pending complaint and motion for summary judgment in the United States District Court for the District of New Jersey. Freehold's complaint, filed on January 19, 1994, seeks declaratory judgment that the Board's January 5, 1994 Order directing negotiations among the parties and "threatening revocation of its prior regulatory approval" are preempted by the Public Utilities Regulatory Policies Act of 1978 (PURPA), 16 U.S.C.A. Sections 796 and 824a-3 et seq., and the regulations promulgated pursuant thereto by the Federal

Energy Regulatory Commission (FERC). Freehold also seeks an order permanently enjoining enforcement of these provisions of the January 5, 1994 Order. On February 8, 1994, Freehold filed a motion for summary judgment with the federal court, seeking an order granting summary judgment in its favor on the issues raised in its complaint and request for injunctive relief.

Freehold has requested that the Board suspend any proceedings on the PPA pursuant to its Order of January 5, 1994 until the question of preemption is definitely resolved. Freehold contends that if the Board proceeds with hearings affecting the PPA while the preemption issue is before the federal court, Freehold will suffer irreparable harm. Freehold contends that the proposed hearings will create a "cloud on the terms of the PPA" which will create uncertainty about this project in the financial community. Freehold also cites the burden and expense of defending itself before the Board.

By letter dated February 17, 1994, JCP&L responded to Freehold's February 10, 1994 letter and opposed the request for a stay. JCP&L contends that Freehold has not met the legal requirements for a stay, in that it has not demonstrated a likelihood of success on the merits or a showing of irreparable harm to justify a stay. Neither has it demonstrated that the legal right underlying its claim is well settled or that the balance of the equities weighs in its favor. JCP&L urges the Board to deny the request for a stay and to proceed with the contemplated hearings in light of the significant and adverse financial impact on JCP&L and its customers stemming from the PPA. By letter dated February 17, 1994, Rate Counsel also opposed the request for a stay.

**Discussion**

The issues before us at this time are whether to grant Freehold's request for a stay of further proceedings before the Board, pending resolution of Freehold's complaint in federal court and, if not, what the scope and schedule of our proceedings should be.

Pursuant to N.J.A.C. 14:1-8.7(d), a stay will be granted for "good cause shown." The criteria for determining good cause for the granting of emergent relief such as the imposition of a stay pending appeal are well settled. For a stay to be granted, the moving party must show:

1. that the movant will suffer immediate and irreparable harm if a stay is not granted;

2. that there is a reasonable probability that the moving part will succeed on the merits;

3. that the legal right underlying the movant's claim is well settled; and

4. that the balance of the equities in granting or denying relief weighs in the movant's favor.

Crowe v. DeGioia 90 N.J. 125 (1982); Zoning Board of the Township of Sparta v. Service Electric Cable T.V. of N.J. Inc., 198 N.J. Super. 170 (App. Div. 1985); Doumani v. Casino Control Commission of New Jersey, 614 F. Supp. 1465 (D.N.J. 1985).

A review of Freehold's request for a stay in light of these criteria reveals an inadequate showing to justify the imposition of a stay. Based on our review of the record in this matter, we do not believe that Freehold has satisfied even a single one of the above criteria.

First, Freehold has failed to demonstrate that it will suffer any immediate or irreparable harm absent a stay of the Board's Order. Freehold claims that if the Board proceeds with hearings there will be a cloud on the terms of the PPA, which will create uncertainty in the financial community. However, in November 1993, in support of the Joint Agreement between Freehold and Staff, Freehold asserted that lenders would not make commitments to finance the project until the rate issue was resolved. It is clear to us that uncertainty regarding this project has existed in the financial community for some time because of the uneconomic nature of the project and that the uncertainty will continue to exist until all issues involved in this matter are resolved.

Freehold also claims that the federal court will be able to resolve this matter more expeditiously than the Board in order to remove the uncertainty. This is unlikely if we were to retain this matter at the Board and adopt the procedural hearing schedule as set forth below. This schedule would enable the matter to be ready for Board consideration in late April, after development of a full record and evidentiary hearing(s). Freehold had originally proposed an anticipated return date of March 28, 1994 for its motion for summary judgment in federal court. Moreover, any decision rendered by the United States District Court will likely be appealed by the unsuccessful party. Clearly, whether the Board grants a stay or not, uncertainty about the PPA will likely exist for some time, until the entire matter is finally resolved and all appeals are completed. If anything, having the Board retain and hear this matter on the schedule set forth below may well bring the matter to a more expeditious resolution than granting a stay at this time.

Second, Freehold has not conclusively demonstrated that it is likely to prevail on the merits in federal court. The issue raised by Freehold's complaint and motion for summary judgment has not been conclusively decided by the courts. As stated in JCP&L's responses in opposition to the request for a stay, Freehold's preemption arguments are far more complex and uncertain than Freehold Asserts. Freehold argues that the Public Utility Regulatory Policies Act of 1978 (PURPA) and federal regulations adopted thereunder by the Federal Energy Regulatory Commissioners, preempt the actions contemplated by the Board citing the recent decision of the Oklahoma Supreme Court in Smith Management Inc. v. The Corporation Commission and Public Service Commission of Oklahoma. The Board notes that the Oklahoma decision was decided by a 6-3 vote and that, as pointed out by JCP&L in its January 7, 1994 letter brief, a review of the Oklahoma decision discloses numerous factual and legal distinctions from the issues facing the Board in this case. Primarily, the cogenerator in the Oklahoma decision did not have a negotiated power purchase agreement with the utility. Moreover, as described above, the FERC regulations provide that an electric utility and a cogenerator can agree to terms and conditions that differ from those in the regulations. The presence of an express clause in the PPA wherein the

parties, without any reservations, agreed to certain procedures in the event the Board were to disallow charges associated with the agreement from being passed on to the JCP&L ratepayers, casts doubt on Freehold's claim that it is likely to prevail on the merits. In addition, as JCP&L notes in its letter opposing a stay, there appears to be good cause for the federal court to dismiss Freehold's complaint on abstention and other grounds, including comity, election and exhaustion of remedies. If this occurs, the merits of Freehold's preemption argument will not be reached in federal court until after the Board conducts a proceeding, if at all.

The balance of the equities is clearly not in Freehold's favor. If we deny the request for a stay, Freehold will have a full and fair opportunity to raise its preemption argument and other legal and factual arguments against further Board action in a proceeding before the Board. In addition, Freehold's alleged burden and expense in "defending" itself before the Board is not sufficient reason for a stay. For these reasons, Freehold's request for a stay is HEREBY DENIED.

In its January 5, 1994 Order, the Board stated that if negotiations between Freehold and JCP&L failed, it would hold a hearing pursuant to N.J.S.A. 48:2-40 to consider whether to modify or revoke its Order approving the PPA and the ratemaking pass-through of the costs associated therewith to JCP&L's customers. N.J.S.A. 48:2-40 grants the Board at any time the power to revoke or modify an order made by it. Tp. of Deptford v. Woodbury Terrace Sewerage Corp. 54 N.J. 418, 425 (1969); N.J. Bell Tel. Co. v. Bd. of Pub. Util. Comm's. 12 N.J. 568, 579 (1953) Central R. Co. of N.J. v. Dept. of Public Utilities, 7 N.J. 247, 254-255 (1951); Sudler v. Environ. Disposal Corp., 219 N.J. Super. 52, 62 (App. Div.) certif. denied 109 N.J. 56 (1987). The Board also possesses authority to "[i]nvestigate upon its own initiative . . . any matter concerning any public utility." N.J.S.A. 48:2-19. The Board also has a continuing obligation under N.J.S.A. 48:2-21 to ensure that a utility's rates are just and reasonable. In re Revision of Rates by Redi-Flo Corp. 76 N.J. 21 (1978).

While we are mindful of the need for rate stability in purchase power agreements and while reconsideration of our

ratemaking treatment of the rates associated with such an agreement is not a step to be taken lightly, given the magnitude of the discrepancy which has developed between the rates under this Agreement and current projections of avoided costs, combined with the fact that the project has not yet been financed nor commenced construction, we believe that our continuing authority to assure that the rates of JCP&L are just and reasonable requires us to reopen the record in this matter to consider what, if any, actions we can and should take at this time consistent with applicable law and our regulatory mandate under N.J.S.A. 38:2-21.

In light of the substantial decline in avoided costs since the Board's approval of the Freehold PPA, the failed negotiations between Freehold and JCP&L and the Board's powers under N.J.S.A. 48:2-21 and 48:2-40, the Board HEREBY DETERMINES to retain this matter and to hold evidentiary hearings to consider the following issues:

1. The status of the Freehold project;

2. The viability of the project, including the prospects for meeting remaining milestones and obtaining financing;

3. The economics of the project, including the amounts expended to date, the projected costs of the project, a comparison of the rates under the PPA to JCP&L's most current avoided cost estimates, and the impact of the costs associated with the PPA on ratepayers;

4. Whether the Board can reconsider, modify or revoke its 1992 Order approving the PPA and allowing for the pass-through of the rates associated with the PPA to JCP&L ratepayers;

5. Whether the Board should reconsider, modify or revoke its 1992 Order approving the PPA setting the level of rates associated with the PPA permitted to be passed through to JCP&L ratepayers, and if so, to what extent;

6. Whether the Board can order a reasonable buy-out of the PPA;

7. Whether the Board should order a buy-out of the PPA and if so at what price.

We note that Freehold's preemption arguments can certainly be raised in the context of these issues. Accordingly, we HEREBY DENY Freehold's request for a stay of the proceedings and we will commence a proceeding to consider the above issues.

At our February 18, 1994 agenda meeting we established a procedural schedule which among other things, set the date for prefiled testimony as March 14, 1994, established hearing dates on March 21 and 22, 1994 and dates for briefs and reply briefs on March 31, 1994 and April 6, 1994, respectively. On February 28, 1994, Freehold filed an Emergent Motion for Reconsideration of the Board's Oral Decision of February 19, 1994, which established a scheduled for discovery, hearings and briefing. Freehold characterizes the hearing schedule as being highly abbreviated. It asserts that the Board expedited the schedule based on two incorrect assumptions. The first being that the parties are familiar with the issues involved. Freehold asserts that the legal, policy and factual issues are far more complex than the Board assumed. Specifically Freehold is concerned that the parties be given sufficient time to present arguments on the possibility that any Board action to modify or revoke its approval of the PPA would be preempted by federal law and/or be contrary to state and federal constitutional provisions and that the parties have the opportunity to fully explore the economics of the Freehold cogeneration project. Freehold also put for the loss of its long-time counsel as a reason for giving them additional time.

The second assumption which Freehold refers to is that the hearing schedule takes into account Freehold's previously stated concern that financing for the project will be difficult to obtain until the matter is resolved. Freehold expresses concern that if the purchase terms are altered it will not be able to obtain financing. It now argues that it should

be given "a complete opportunity to develop a full record in an orderly manner."

Based on these arguments, Freehold asks the Board to alter the hearing schedule in one of three ways. First Freehold asks that the Board transmit the matter to the OAL so that a complete record can be developed. Alternatively, Freehold asks that the schedule be restructured to provide for a phased consideration of the issues starting with the extent of the Board's authority under federal and state law. Freehold's last request is that the submission of pre-filed testimony be deferred two weeks until March 28, 1994 so the district court be given time to rule on Freehold's motion for summary judgment[1] and the parties be given sufficient time to assimilate the material obtained through discovery and obtain the services of non-party experts and other witnesses.

Replies to Freehold's Motion were filed by JCP&L and Rate Counsel. Both JCP&L and Rate Counsel objected to Freehold's request to send the matter to the OAL and for a phased consideration. Both JCP&L and Rate Counsel expressed a desire to keep the process moving. However, JCP&L did not object to a two week delay in the schedule, nor did Rate Counsel specifically object.

Given our prior determination to hear this matter directly, we remain convinced that Freehold's request that the matter be transmitted to the OAL be denied. N.J.S.A. 52:14F-8(b) provides than an Administrative Law Judge shall

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1 At a conference call with United States District Court Judge Mary Little Parell held on Tuesday, February 22, 1994, the Judge set Oral Argument for Wednesday, March 14, 1994, and indicated she would attempt to rule from the bench after Oral Argument on Freehold's Motion for Summary Judgment and the cross-motions to dismiss. At that time the Judge also expressed the hope that the Board would consider Freehold's request for a two-week extension favorably.

not be assigned to hear "[a]ny matter where the head of an agency, a commissioner or several commissioners, are required to conduct or, determine to conduct the hearing directly or individually." An agency's determination to hear a case directly rather than to transfer the case to the OAL is within the agency's discretion, and the agency head clearly has the right not to transfer a case to the OAL. In re Uniform Admn'n Procedure Rules, 90 N.J. 85, 90-92, 104 n. 8 (1992); Unemployed-Employed Council of N.J. Inc. v. Horn, 84 N.J. 646, 654 (1980); Frank v. Ivy Club, 228 N.J. Super. 40, 55 (App. Div. 1988), rev'd on other grounds, 120 N.J. 73 (1990), cert. denied, 498 U.S. 1073, 111 S.Ct. 799, 112 L.ed. 2d 860 (1991); Matter of Cole, 194 N.J. Super. 237, 245-45 (App. Div. 1980), app. dismissed, 84 N.J. 433 (1980).

Accordingly the Board HEREBY REAFFIRMS its determination to hear this matter because of the important legal, factual and policy decisions involved and because there is no requirement that the matter be transmitted to the OAL.

The Board is convinced that Freehold's request that the hearing schedule provide for phased consideration of the issues should be denied. The Board will give all parties a full and fair opportunity to raise all issues relevant to this matter. Freehold has already asked for and has been given additional time by counsel for the other parties for the submission of discovery requests. By agreement of all parties, the date for discovery requests was moved from Friday February 25, 1994 to Tuesday March 1, 1994 and the date for responses was moved from Friday March 4, 1994 to Tuesday March 8, 1994. This action allows Freehold's new counsel the opportunity to familiarize himself with the issues. In addition, Freehold has other counsel which have continued to work on the matter and should be familiar with the issues involved in discovery.

However, the Board will grant Freehold's last request and defer the submission of pre-filed testimony for two weeks. Such action would defer all other phases of the hearing for two weeks. Deferral of submission of pre-filed testimony accedes to Judge Parell's request that in the interests of comity the Board grant Freehold an extension and

would likely avoid a filing by Freehold for an emergent stay in federal court. A two-week delay could also see resolution of the federal district court case in either party's favor. If resolved in Freehold's favor all concerned parties will have been spared unnecessary work, pending the outcome of any subsequent appeals which may result. If the Board prevails, the hearing schedule can proceed without the interference that could result from a simultaneous federal court proceeding. Deferral also gives the parties more time to fully prepare themselves for the remainder of the hearing schedule. The delay that would result from such deferral is minor and still allows the Board to resolve this matter expeditiously.

Accordingly, we HEREBY DENY Freehold's request to transmit this matter to the OAL and for a phased consideration of the issue before the Board. We HEREBY GRANT Freehold's request for a two week delay in the filing of prefiled testimony and subsequent hearing dates and briefs. Accordingly, the revised procedural schedule will be as follows:

Responses to the first round of testimony:

Tuesday, March 8, 1994
Monday, March 28, 1994
Wednesday, April 6, 1994
Thursday, April 7, 1994 at 9:30 a.m. at the Board's hearing room Two Gateway Center, Newark, NJ

Briefs: Friday, April 15, 1994
Reply Brief: Thursday, April 21, 1994

The parties may continue to exchange follow-up discovery requests up through the beginning of the hearings. The parties are directed to cooperate to respond to these requests as promptly as possible, in light of the above schedule.

JCP&L is directed to provide appropriate notice of the hearings consistent with applicable law.

Copies of all documents should be served on all parties no later that 5:00 p.m. on the above dates. Copies

should also be filed with the Board at its Trenton offices with copies to Board's Staff in Newark and the Attorney General's Office in Newark. Parties should be prepared to execute appropriate confidentiality agreements, if necessary. If there are any disagreements among the parties concerning discovery or other procedural matters, these should be brought to the attention of the advising Deputy Attorney General, with copies to all parties. If any such matter cannot be resolved among the parties, the issue will be brought back to the Board's agenda for resolution.

The above schedule is, in our view, reasonable and necessary in light of the cloud of uncertainty which Freehold contends now hangs over the project. We further believe that the schedule is reasonable because the parties' familiarity with the subject matter obviates the need for a lengthy and extensive discovery process.

Concurrent with its filing of its Emergent Motion for Reconsideration of the Board's hearing schedule, Freehold filed a Motion for Reconsideration of the Board's Order of January 5, 1994 concerning this matter. The issues raised in

that Motion will be considered by the Board at a future meeting and memorialized in a separate order.

DATED: March 7, 1994

BOARD OF REGULATORY
COMMISSIONERS

BY: /s/

HERBERT H. TATE, JR.
PRESIDENT

/s/
CARMEN J. ARMENTI
COMMISSIONER

/s/
DR. EDWARD H. SALMON
COMMISSIONER

ATTEST:

/s/
JULIE FORD
ACTING SECRETARY

# APPENDIX F

**UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

April 26, 1994
#A-116

No. 94-5168

FREEHOLD COGENERATION ASSOCIATES, L.P.,
Appellant
v.
BOARD OF REGULATORY COMMISSIONERS OF THE STATE OF NEW JERSEY;
JERSEY CENTRAL POWER AND LIGHT COMPANY
(DNJ (Trenton) D.C. Civil No. 94-375 (MLP))

Present: BECKER and NYGAARD, Circuit Judges.

1. Motion by Appellant requesting the Court to ask the Federal Energy Regulatory Commission to submit a brief as an amicus curiae.

2. Motion by Appellee Board of Regulatory Commissioners of the State of New Jersey for acceptance of late response.

/s/
Mary Arnold 597-5019
Deputy Clerk

## ORDER

The foregoing motions are granted. The Federal Energy Regulatory Commission is requested to submit a brief amicus curiae on the jurisdictional issues facing this Court by July 1, 1994. The Appellees' brief shall be filed within thirty (30) days of the filing of the amicus curiae brief; Appellant's reply brief shall be filed within fourteen (14) days of the filing of Appellees' brief. The Commission is invited to address any of the other issues raised by this appeal that it desires to. The parties shall supply Commission counsel with the relevant papers.

By the Court,

_____

Circuit Judge

Dated: May 6, 1994

# APPENDIX G

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 94-5168

FREEHOLD COGENERATION ASSOCIATES, L.P.,
PLAINTIFF-APPELLANT,
v.
BOARD OF REGULATORY COMMISSIONERS OF
THE STATE OF NEW JERSEY, ET AL.,
DEFENDANTS-APPELLEES.

On Appeal from the United States District
Court for the District of New Jersey
Honorable Mary Little Parell, Judge

# BRIEF FOR AMICUS CURIAE FEDERAL ENERGY REGULATORY COMMISSION SUPPORTING PLAINTIFF-APPELLANT

SUSAN TOMASKY
GENERAL COUNSEL

JEROME M. FEIT
SOLICITOR

SAMUEL SOOPPER
ATTORNEY

FOR AMICUS CURIAE
FEDERAL ENERGY
REGULATORY
COMMISSION
WASHINGTON, D.C. 20426

JULY 1, 1994

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IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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No. 94-5168

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FREEHOLD COGENERATION ASSOCIATES, L.P.,
PLAINTIFF-APPELLANT,

v.

BOARD OF REGULATORY COMMISSIONERS OF
THE
STATE OF NEW JERSEY, ET AL.,
DEFENDANTS-APPELLEES.

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On Appeal from the United States District
Court for the District of New Jersey
Honorable Mary Little Parell, Judge

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BRIEF FOR AMICUS CURIAE FEDERAL ENERGY
REGULATORY COMMISSION
SUPPORTING PLAINTIFF-APPELLANT

---

## STATEMENT OF INTEREST

This brief is filed in response to the Court's Order of May 6, 1994, requesting the Federal Energy Regulatory

Commission ("Commission" or "FERC") to address "the jurisdictional issues facing this Court" and inviting the Commission to respond to "any of the other issues raised by this appeal that it desires to." FERC will limit its response to the jurisdictional issues and the related issue of abstention.

## STATEMENT OF JURISDICTION

FERC agrees with the jurisdictional statement contained in the brief (Pet. Br. 1) of plaintiff-appellant Freehold Cogeneration Associates, L.P. (Freehold), that the district court had jurisdiction pursuant to 28 U.S.C. § 1331 over this action to enforce the exemption of the Public Utility Regulatory Policies Act of 1978 (PURPA) for Qualifying Facilities (QFs) from state rate and financial regulation, 16 U.S.C. § 824a-3(e), and the commission's rules promulgated thereunder. 18 C.F.R. § 290.101, et seq.

## STATEMENT OF THE ISSUES

The Commission will address the following issues:

1. Whether the district court erred in its conclusion that it was without jurisdiction to entertain Freehold's complaint because of the jurisdictional limitations of Section 210(g) of PURPA, 16 U.S.C. § 824a-3(g).

2. Whether the district court erred in finding that the Johnson Act, 16 U.S.C. § 1342, deprived it of jurisdiction to review the order of a state commission challenged on the ground that it violated PURPA.

3. Whether the district court could properly rely on the contract between Freehold and Jersey Central Power & Light (Jersey Central) to find it was without jurisdiction over Freehold's complaint.

4. Whether the complaint is dismissible under the principles of abstention established by Younger v. Harris, 401 U.S. 37 (1971), Burford v. Sun Oil Co., 319 U.S. 315 (1943), and Railroad Commission of Texas v. Pullman, 312 U.S. 496 (1941).

## PERTINENT STATUTORY AND REGULATORY PROVISIONS

The statutory and regulatory provisions pertinent to this case are contained in the Addendum to this brief.

## STATEMENT OF THE CASE

### I. Nature of the Case and Proceedings Below

We adopt the statement in Freehold's brief (at pp. 4-5) concerning the nature of the case.

### II. Statement of Facts

#### A. Regulatory Context

1. Under Part II of the Federal Power Act (FPA), 16 U.S.C. § 824 et seq., the Commission has the exclusive authority to regulate "public utilities" that sell electric power at wholesale in interstate commerce. See 16 U.S.C. § 824(e). In 1978, Congress modified the FPA with the enactment of PURPA, which was designed "to encourage the development of cogeneration and small power production facilities" to foster increased use of alternatives to fossil fuels. FERC v. Mississippi, 456 U.S. 742, 750 (1982)(footnote omitted).

PURPA defined a "cogeneration facility" as one which produces both electricity and "steam or forms of

useful energy (such as heat) which are used for industrial, commercial, heating or cooling purposes." 16 U.S.C. § 796(18)(A). It also created a category of "qualifying cogeneration facilities" (known as QFs), which would include any facility which the "the Commission determines, by rule, meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Commission may, by rule, prescribe," as well as certain ownership requirements. 16 U.S.C. § 796 (18)(B).[1]

2. In enacting PURPA, Congress sought to eliminate two major barriers that had previously impeded the growth of cogeneration facilities: that 11(l) traditional electric utilities were reluctant to purchase power from, and to sell power to, the nontraditional facilities, and (2) the regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the nontraditional facilities and thus discouraged their development." FERC v. Mississippi, supra, 456 U.S. at 750-751 (footnotes omitted).

To meet the first problem, Section 210(a) of PURPA, 16 U.S.C. § 824a-3, required the Commission to prescribe "such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring traditional utilities to purchase electricity from QFs. FERC v. Mississippi, supra, 456 U.S. at 751.[2] To overcome the second barrier, Section 210(e) of the Act requires the Commission to implement regulations exempting

---

1 The PURPA QF category also includes "small power production" facilities using renewable resources to generate electricity, 16 U.S.C. § 796(17), which receive the same statutory benefits as cogeneration QFs such as Freehold.

2 In turn, Section 210(f) of PURPA requires that "each State regulatory authority shall . . . implement" the rules adopted by the Commission under Section 210(a) to encourage QF development. 16 U.S.C. § 824a-3(f).

QFs from such federal regulation to which traditional electric utilities are subject, including most provisions of the FPA, as well as "State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities." 16 U.S.C. § 824a-3(e)(1).

3. In accordance with these provisions of PURPA, the Commission promulgated regulations governing transactions between utilities and QFs, including a specific requirement that a utility must purchase electricity made available by a QF at a rate up to the utility's full avoided cost. 18 C.F.R. §§ 292.303; 292.304 (1993). See generally American Paper Institute, Inc. v. American Electric Power Service Corp., 461 U.S. 402, 414-415 (1983). Avoided cost is defined by the statute as "the cost to the electric utility of the electric energy which, but for the purchase from [a QF], such utility would generate or purchase from another source." Section 210(d), 16 U.S.C. § 824a-3(d).

Acting pursuant to Section 210(e)(1) of PURPA, the commission also promulgated regulations exempting QFs from various federal and state regulatory requirements. 18 C.F.R. § 292.602(c). That section states, in pertinent part:

> (1) Any [QF] shall be exempted . . . from State law or regulation respecting:
>
> (i) The rates of electric utilities; and
>
> (ii) The financial and organizational regulation of electric utilities.

It is this exemption for QFs from state utility regulation, provided for in Section 210(e) of PURPA and further fleshed

out by Commission regulations, which is the basis of Freehold's claim here.

### B. The Proceedings Below.

Freehold, certified as a QF by the Commission in October, 1993,[3] intends to construct and maintain a cogeneration facility in Freehold, New Jersey. To this end, on March 26, 1992, Freehold entered into a long-term Purchase Power Agreement (PPA) with Jersey Central Power & Light Company (Jersey Central), under which Freehold would provide capacity and energy to Jersey Central over a twenty-year period at rates set at 1989 avoided costs. On July 8, 1992, the Board of Regulatory Commissioners of the State of New Jersey (BRC) issued an order approving the PPA and the rates it established. JA. 113-118.

The present dispute stems from the BRC's attempt to reexamine the level of Freehold's avoided cost rates. On April 12, 1993, the BRC issued an order (the Towner order), directing electric utilities to explore remedies for contracts with QFs that were no longer economically sound. JA. 215-223. On January 5, 1994, the BRC issued an order rejecting a settlement reached by its staff and Freehold which would have modified the rates on the ground that "the Joint Agreement leaves the pricing in the [PPA] significantly above current forecasts of avoided cost." JA. at 141. The BRC went on to urge Freehold and Jersey Central to negotiate a modification of the PPA pursuant to Towner, but advised the parties "that if they cannot reach agreement on either reasonable renegotiated pricing terms more consistent with current avoided costs or a buy-out arrangement within 30 days," the BRC would "commence a proceeding to consider

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3 Freehold Cogeneration Associates, L.P., 65 FERC ¶ 62,004 (1993).

whether its previous approval of (the PPA] should be modified or otherwise reconsidered or revoked." Id. at 142. (In fact such a proceeding was instituted and is presently ongoing).

2. At this point, Freehold filed a civil action in the United States District Court for the District of New Jersey against both the BRC and Jersey Central, seeking a declaratory order that BRC's January 5, 1994, order initiating a proceeding to determine whether the PPA should be modified, was preempted by PURPA and asking that court enjoin the state proceeding. The BRC and Jersey Central moved to dismiss the complaint on various grounds, three of which were relied upon by the district court in its March 18, 1994, order dismissing Freehold's complaint.

First, the court found that the case was governed by PURPA's judicial review provisions, 16 U.S.C. § 824a-3(g), which incorporates 16 U.S.C. § 2633, divesting the federal courts of jurisdiction to review certain orders of state regulatory commissions. JA. at 883-884.[4] Second, it held

---

4 Subsection (g) provides:

(1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) of this section in the same manner, and under the same requirements, as judicial review may be obtained under section 2633 of this title in the case of a proceeding to which section 2633 of this title applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f) of this section. Any such action shall be brought only in the manner, and under the requirements, as provided under section 2633 of this title with respect to an action to which section 2633 of this title applies.

that judicial review was precluded by the Johnson Act, 28 U.S.C. § 1342 (set out at p. 16, infra), which curtails federal jurisdiction with respect to orders of state regulatory authorities if certain specified conditions are all met. Id. at 884-887. Third, the judge relied on the choice of law provision in the PPA itself (set out at JA. 104-105). Her reading of the contract indicated that "the parties contemplated that all disputes arising under the PPA would be resolved either by the BRC or by a New Jersey state court." Id. at 887 (emphasis in original).

This appeal followed, while the BRC proceeding continued below.

## SUMMARY OF ARGUMENT

### I.

A. Freehold properly invoked federal court jurisdiction in this case under 28 U.S.C. § 1331. Freehold's claim is that its federally-established PURPA rights under Section 210(e) are being violated by a state proceeding, precisely the type of situation addressed by Section 1331.

The district court's contrary conclusion was based on an erroneous reading of Section 210(g) of PURPA as a broad exception to federal jurisdiction over PURPA claims. Neither subsection of Section 210(g) applies to a claim, like Freehold's, that state action is barred by Section 210(e) and the FERC regulations promulgated thereunder exempting QFs from state utility regulation.

---

Section 2633, 16 U.S.C. § 2633 (reproduced in the statutory appendix), is the general judicial review provision of PURPA, which essentially divests the federal courts of jurisdiction "over any action arising under any provision of subchapter I or III' of PURPA, subject to certain exceptions.

B. The district court's dismissal of Freehold's complaint on the basis of the Johnson Act, 28 U.S.C. § 1342, was also erroneous. Because the statute only bars complaints against state regulatory proceedings where jurisdiction is based "solely on . . . repugnance of the order to the Federal Constitution," governing case law demonstrates that the Johnson Act is no bar to a statutory preemption claim. Since Freehold's claim is clearly based on PURPA, a statutory ground, the district court misapplied the Act. Similarly, the Act's requirement that the state order challenged does not affect interstate commerce is lacking here since any allegation of a PURPA violation inherently contains an allegation of such impact.

C. Finally, the district court's dismissal of the case on the basis of the choice of law clause of the PPA is also erroneous. Freehold accurately, we submit, characterizes its case as a preemption claim brought against the BRC to enforce PURPA rather than a dispute under the PPA. The PPA provision is irrelevant to this issue.

## II.

The abstention doctrine, established in Younger v. Harris, 401 U.S. 37 (1971)(Younger), Burford v. Sun Oil Co., 319 U.S. 315 (1943)(Burford), and Railroad Commission of Texas v. Pullman, 312 U.S. 496 (1941)(Pullman), should not be applied to this case.

A. The inapplicability of Burford abstention is established by the decision of this Court in Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Commission, 791 F.2d 1111 (3rd Cir. 1986), cert. denied, 488 U.S. 941 (1988), and that of the Supreme Court in New Orleans Public Service v. City of New Orleans, 491 U.S. 350

(1986)(NOPSI), which hold the doctrine inappropriate to a claim that federal rate regulation preempts action by a state regulatory body.

B. Younger abstention would also be inappropriate here. This Court has held that state interests protected by Younger are generally outweighed by a claim of federal preemption. In addition, the Supreme Court in NOPSI made clear that a ratemaking proceeding, such as the one here, is a legislative process to which Younger abstention has no application.

C. Finally, Pullman abstention only applies in cases where the court would have to resolve difficult and unsettled questions of state law before a substantial constitutional question can be decided. Neither prerequisite is present in this case, which raises a claim that PURPA, a federal statute, preempts the action of a state regulatory body.

## ARGUMENT

### I. FREEHOLD PROPERLY INVOKED FEDERAL JURISDICTION TO RESOLVE ITS CLAIM THAT ITS FEDERALLY-ESTABLISHED PURPA RIGHTS ARE BEING UNLAWFULLY INFRINGED BY THE STATE REGULATORY ACTION

As described above, even though Freehold brought its complaint under 28 U.S.C. § 1331, the district court ignored this provision while relying on the review provisions of PURPA, the Johnson Act and the terms of the PPA to find it had no jurisdiction to decide Freehold's claims. We believe that the district court's analysis is flawed and that Section 1331 jurisdiction was properly invoked by the Freehold.

## A. The Jurisdictional Limitations Of Section 210(g) Of PURPA Have No Application To This Proceeding

By holding that Section 210(g) of PURPA, 16 U.S.C. § 824a-3, divests the federal courts of jurisdiction in this case, the district court, in our view, not only ignored the Freehold's assertion of jurisdiction under Section 1331, but also the inherent limitations of Section 210(g) itself.

1. At the outset, the district court's assessment of federal jurisdiction did not confront Freehold's assertion that its preemption claim properly invoked federal jurisdiction under 28 U.S.C. § 1331. As we understand it, Freehold's position on this aspect of the case is that its federally-established PURPA rights are being violated by a state proceeding. This is precisely the situation addressed by Section 1331, as the Supreme Court explained in Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 96 n.14 (1983)(authorities omitted; emphasis added):

> It is beyond dispute that federal courts have jurisdiction over suits to enjoin state officials from interfering with federal rights. . . . A plaintiff who seeks injunctive relief from state regulation, on the ground that such regulation is preempted by a federal statute which, by virtue of the Supremacy Clause of the Constitution, must prevail, thus presents a federal question which the federal courts have jurisdiction under 28 U.S.C. § 1331 to resolve.

Accord, Airco Industrial Gases, Inc. v. Teamsters Health and Welfare Pension Fund, 850 F.2d 1028, 1032-1035 (3rd Cir. 1988).

The district court apparently believed that Section 1331 was irrelevant because it read PURPA Section 210(g) as carving out a broad exception to federal jurisdiction over PURPA claims other than judicial review of a final decision by FERC. JA. at 884. In the court's view (id.),

> [B]y enacting [Section 210(g)] and § 2633, Congress specifically provided that judicial review of orders by the State regulatory authorities was to made only by the state courts or FERC. The only instance where Congress provided for federal jurisdiction is where a party seeks judicial review of a decision by FERC. Here, FERC has made no determination which this Court might review, nor does Freehold allege this as a basis for jurisdiction. Thus, under PURPA, this Court does not have jurisdiction over Freehold's challenge to the BRC's order. See Greensboro Lumber Co. v. Georgia Power Co., 643 F. Supp. 1345, 1374 (N.D. Ga. 1986), aff'd, 844 F.2d 1538 (11th Cir. 1988).

As a fair reading of the text of Section 210(g) reveals, the court misapprehended the carefully limited scope of that provision.

Subsection (1) of Section 210(g) applies only to review of proceedings by state regulators or nonregulated utilities designed to "implement[] any requirement" of rules

promulgated by the Commission pursuant to Section 210(a), 16 U.S.C. § 824a-3(a). (Section 210(a), as we explained above, was the mandate under which the Commission promulgated its original rules requiring electric utilities to purchase and sell electricity to and from QFs. See 18 C.F.R. Part 292, Subparts A, B.)

Freehold's claim, however, is not a challenge to the validity of state action implementing the rules adopted by the Commission pursuant to Section 210(a) of the Act, but that the BRC proceeding is inconsistent with and preempted by Section 210(e) and the FERC regulations promulgated thereunder, which exempt QFs from state utility regulation. 16 U.S.C. § 824a3(e)(1); 18 C.F.R. § 292.602(c). Accordingly, the jurisdictional limitations of Section 210(g)(l)--regarding state proceedings "implementing any requirement of a rule" enacted under that section--have no relevance to the federal jurisdiction alleged here by Freehold. Rather, the gravamen of Freehold's claim is that the BRC is subjecting it to the very utility regulation precluded by Section 210(e) and the Commission's implementing regulations.

The jurisdictional limitations of Subsection (2) of Section 210(g) are of even less relevance to Freehold's action. That subsection applies to cases brought by any person against a QF (or other small power producer) to enforce any requirement established by state regulatory authorities or nonregulated utilities pursuant to Section 210(f), which governs the sale and purchase of electricity between utilities and QFs- But the instant case involves neither a state regulation promulgated pursuant to Section 210(f), nor is brought by a person against a QF to enforce such a requirement.[5]

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5 Our position here is fully consistent with the Commission's "Policy Statement Regarding the Commission's Enforcement Role Under Section 210 of [PURPA]," 23 FERC ¶ 61,304 (May 31, 1983), relied on

2. The recent case of Bristol Energy Corp. v. State of New Hampshire Public Utilities Commission, 13 F.3d 471, 474 (1st Cir. 1994), is also instructive in this regard. There, similar to Freehold's assertion here, several QFs brought an action against a state commission claiming that a regulatory proceeding violated the PURPA exemption and was thus preempted. The First Circuit rejected the contention that federal jurisdiction over the claim was lacking, holding that Section 1331 authorized review of state action that allegedly interfered with PURPA's QF exemption. In specifically rejecting the claim that Section 210(g) divested it of jurisdiction, the court described that section as "plac[ing] limits on federal jurisdiction in proceedings involving rules implementing 16 U.S.C. §§ 824a-3(a) and -3(f), rules not at issue in this case." 13 F.2d at 474 (footnote omitted).

This reasoning should govern here as well, for as in Bristol, Freehold's claim here is based on the Section 210(e) exemption, not rules implementing either subsections (a) or (f). Accordingly, the district court erred in dismissing Freehold's complaint on the basis of the PURPA jurisdictional limitations.[6]

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by the district court. JA. 883-884. The Policy Statement did not discuss Section 210(g) jurisdiction in cases arising under Section 210(e).

6 Greensboro Lumber Co., supra, on which the district court relied, is not to the contrary. There, the court held that Section 210(g) divested it of jurisdiction over a claim that a nonregulated utility had failed to adhere to its own implementation plan in its dealings with a particular QF. 643 F. Supp. at 1374. Rather, the court held, the statute requires that such a claim "must be [brought] in state court, which has exclusive jurisdiction 'to enforce any requirement' of a nonregulated utility's implementation plan." Id. The case thus involved a claim under Section 210(f)(1), not a complaint such as Freehold's, invoking the Section 210(e) exemption.

## B. The Johnson Act Does Not Apply To A Complaint Asserting That Federal Law Preempts A State Regulatory Action

1. The second basis for the district court's dismissal of Freehold's complaint was that dismissal was required by the Johnson Act, 28 U.S.C. § 1342. JA. 884-887. In our view, the court's reliance on the Johnson Act in these circumstances of this case was clearly erroneous.

The Johnson Act provides:

> The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public utility and made by a State administrative agency or a ratemaking body of a State political subdivision, where:
>
> (1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and,
>
> (2) The order does not interfere with interstate commerce; and
>
> (3) The order has been made after reasonable notice and hearing; and
>
> (4) A plain, speedy and efficient remedy may be had in the courts of such State.

As the district court correctly recognized, all four of the Act's criteria must be met for it to apply. JA. 885. While the court held that the elements were all present here, its reasoning was unsound.

2. First, the court below concluded the statute's demand that "jurisdiction be based solely on . . . repugnance of the order to the Federal Constitution," was present because (JA. 885-86)

> Freehold seeks declaratory and injunctive relief in this action on the basis that the BRC's Order dated January 5, 1994[,] is preempted by PURPA. The doctrine of pre-emption is based on the Supremacy Clause of the Federal Constitution. . . . It is apparent that Freehold alleges jurisdiction on the basis that the Order is repugnant to the Federal Constitution since Freehold claims that the Supremacy Clause mandates the Order give way to PURPA. (authority and footnote omitted).

This analysis, however, wholly ignores the Johnson Act's explicit requirement that such claims be based "solely" on the federal constitution. As the United States Court of Appeals for the Fifth Circuit explained in holding that the Johnson Act was no bar to a preemption claim based on the Federal Power Act, "a federal question about the preemptory effect" of the Act "cannot be seen to rely 'solely' on constitutional grounds." New Orleans Public Service, Inc. v. City of New Orleans, 782 F.2d 1236, 1242 (5th Cir. 1986), vacated in part on other grounds, 798 F.2d 858 (1986), cert. denied, 481 U.S. 1023 (1987). Thus, the court concluded, "[a] statutorily-based preemption claim will not provide a basis for invoking

the Johnson Act to deprive federal courts of jurisdiction." 782 F.2d at 1242-43 (authorities omitted). Accord, Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission, 620 F. Supp. 1458, 1460-61 (M.D. Pa. 1985), rev'd on other grounds, 791 F.2d 111 (3rd Cir. 1986).[7]

3. While this error is in itself sufficient to reverse the district court's holding with respect to the Johnson Act, there are additional deficiencies in its interpretation. Concerning the Act's requirement that the contested order "not interfere with interstate commerce," the court opined in conclusory fashion: "There is no indication that the Order interferes with interstate commerce; nor does Freehold assert any interference with interstate commerce." JA. 886.

This is plainly wrong. As the Supreme Court explained in FERC v. Mississippi, supra, "it is difficult to conceive of a more basic element of interstate commerce than electric energy," 450 U.S. at 757. Indeed, the Court observed that Congress, in enacting PURPA, specifically employed its poster under the commerce clause of the constitution because federal regulation of "relationships between cogenerators and electric utilities[] was essential to protect interstate commerce." 456 U.S. at 758. It is only by ignoring these salient considerations that the district court could in such an offhand manner find that Freehold had failed to allege that the BRC order did not affect interstate commerce. On the contrary, in view of the description of the statute, Freehold's allegation that the state order violates PURPA inherently contains an allegation that it interferes with interstate commerce.

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7 See also International Brotherhood of Electric Workers v. Public Service Commission o. Nevada, 614 F.2d 206 (9th Cir. 1980); Aluminum Company of America v. Utilities Commission of North Carolina, 713 F.2d 1024 (4th Cir. 1983), cert. denied, 465 U.S. 1052 (1984).

Because two of the elements essential for the Johnson Act to bar federal jurisdiction are missing here, the district court's dismissal of Freehold's complaint on this basis was clear error.

### C. The District Court's Reliance On the PPA

As we have described above, the district court's third rationale for dismissing the case was the choice of law clause of the PPA. In the court's view (JA. 887),

> the parties provided that the PPA "shall be governed by and construed in accordance with the laws of the State of New Jersey applicable to contracts made and to be performed in that State, irrespective of the application of any conflicts of laws provisions." (PPA ¶ 28.1(a).) Further, the parties "agree[d] that all disputes arising under [the PPA] not resolved between the parties shall be decided by a petition to the BRC or a court of competent jurisdiction in the State of New Jersey and [Freehold] hereby submits itself to the jurisdiction of the BRC or such court for such purposes." (PPA ¶ 28.1(b).)

It is true that nothing in PURPA nor its regulations prevents Freehold from waiving its statutory rights. See 18 C.F.R. § 292.301(b)(1). Hence there is no legal bar to Freehold consenting to having PPA disputes heard in state court. Freehold argues, however, that the choice of law provision is irrelevant to its complaint because its case is a preemption claim arising under PURPA brought against the BRC, not a

dispute under the PPA. Pet. Br. 28-29. Because Freehold's characterization of the PPA case is plainly correct from the face of the agreement, we believe that the district court erred in employing the PPA as a vehicle for rejecting jurisdiction over the case.[8]

## II. BECAUSE THE STATE AUTHORITY OVER FREEHOLD'S RATES IS EXCLUSIVELY DERIVED FROM PURPA, THE ABSTENTION DOCTRINE IS INAPPROPRIATE HERE

Appellees argued extensively below that the district court should not hear Freehold's claim against the BRC on the basis of the abstention doctrine, the major strands established in Younger v. Harris, 401 U.S. 37 (1971) (Younger), Burford v. Sun Oil Co., 319 U.S. 315 (1943) (Burford), and Railroad Commission of Texas v. Pullman, 332 U.S. 496 (1941) (Pullman).

As this Court has explained, the doctrine is

> in all its forms. . . an extraordinary and narrow exception to the district court's duty to adjudicate a controversy properly before it, justified only in the exceptional circumstances where resort to state proceedings clearly serves an important countervailing interest.

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8 The merits issue of whether the PPA's "regulatory out" clause, ¶ 20.2(a) of the Agreement, JA. 99-100, represents a waiver by Freehold of its right to lock-in its avoided cost rate at the 1989 level, also involves interpretation of the PPA. The Commission takes no position on this issue, since its resolution involves, inter alia, contract interpretation under state law. As noted (supra p. 1), the Commission does not address any merits issue in this brief but has limited its response to the jurisdictional issues and the related issue of abstention.

United Service Automobile Association v. Muir, 792 F.2d 356, 360-61 (3rd Cir. 1986), cert. denied, 479 U.S. 1031 (1987), citing Colorado River Water Conservation District v. United States, 424 U.S. 800, 813 (1976).

Because this case presents no such extraordinary situation, it would be legally erroneous here to apply the abstention doctrine in any of its aspects.

### A. Burford Abstention Is Inappropriate Here

The inapplicability of Burford abstention is directly established by this Court's decision in Kentucky West Virginia Gas Company v. Pennsylvania Public Utility Gas Company v. Pennsylvania Public Utility Commission, 791 F.2d 1111 (3rd Cir. 1986), cert. denied 488 U.S. 941 (1988) (Kentucky West Virginia), as well as that of the Supreme Court in New Orleans Public Service v. City of New Orleans (NOPSI) 491 U.S. 350, 360-362 (1989).

In Kentucky West Virginia, this Court explained that Burford abstention was appropriate in two situations (791 F.2d at 115):

> [F]irst, where there have been presented difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar; and second, where the exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern. (quoting Colorado River, supra, 424 U.S. at 814)(internal

quotation marks omitted)(emphasis added).

There, a utility company challenged a state regulatory commission's retail rate orders on the ground that they were preempted by the Natural Gas Act and the Natural Gas Policy Act. While acknowledging the great interest the states have in regulating retail rates, the Court noted that other circuits had adopted the view that "Burford abstention is almost never appropriate where a federal plaintiff asserts a preemption claim" because "[t]he purpose of Burford abstention is to avoid federal intrusion into matters of local concern which are within the special competence of local courts," while "federal courts are particularly appropriate bodies for application of preemption principles." 791 F.2d at 1115, quoting International Brotherhood of Electrical Workers, supra, 614 F.2d 206, 212 n.1 (9th Cir. 1980), vacated on other grounds, 468 U.S. 491 (1984) & Kennecott Corp. v. Smith, 637 F.2d 181, 185 (3rd Cir. 1980), quoting Hagans v. Levine, 415 U.S. 528, 550 (1974).

Applying these principles, the Court in Kentucky West Virginia held Burford abstention inappropriate where a complaint alleged that federal rate regulation preempts action by a state regulatory body. Here, Freehold also claims to vindicate a federal interest created by PURPA, a federal law. Indeed, as we have explained above, state regulation of CIF rates derives solely from federal law. Proper application of the principles of Kentucky West Virginia to the case at bar thus rejects the propriety of Burford abstention here.

The Supreme Court decision in NOPSI is likewise dispositive. That case was brought by an electric utility against a local retail ratemaking body where the utility alleged an order of the local commission conflicted with a FERC decision and thus found Burford violated preemption principles. The Court found Burford abstention inapplicable

because resolution of the complaint involved no federal intrusion into state law or policy. Rather, it required inquiry into Federal Power Act principles, a matter of exclusive federal concern. 491 U.S. at 363-364.

Here, similarly, this Court's examination whether the BRC's orders violate PURPA does not impermissibly intrude into New Jersey's interests. Indeed, any judicial analysis of the rights and responsibilities of Freehold and the BRC under PURPA manifestly requires a review of what is permissible under federal law.

### B. Younger Abstention Is Similarly Inappropriate

Younger abstention similarity has no application in the present context.

As an initial matter, Kentucky West Virginia, supra, establishes that Younger abstention would be improper here. While Younger could apply only where the state proceeding at issue "must implicate important state interests,"[9] state interest in retail rate regulation, the Court reasoned, fell before an "equally important federal interest in regulating interstate gas rates, authority over which Congress has vested exclusively in FERC." 791 F.2d at 1116. Thus, the Court concluded, abstention was improper because "[t]he legitimate state interests contemplated by Younger . . . do[] not exist when state action has been preempted or foreclosed by the Constitution." 791 F.2d at 1116-1117, quoting Middle South Energy Inc. v. Arkansas Public Service Comm'n, 772 F.2d 404, 417 (8th Cir. 1985), cert. denied, 474 U.S. 1102 (1986) (additional authorities omitted).

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9 791 F. 2d at 1116, quoting Coruzzi v. State of New Jersey, 705 F.2d 688, 690 (3rd Cir. 1983); Middlesex County Ethics Comm. v. Garden State Bar Ass'n, 457 U.S. 423 (1982).

In any event, any reliance on Younger is clearly foreclosed by the Supreme Court's decision in NOPSI, which specifically held that because ratemaking is a legislative, father than a judicial, process, Younger abstention does not apply to a state ratemaking proceeding. 491 U.S. at 367-70. The same rationale governs here.

### C. Pullman Abstention Is Likewise Inappropriate

Finally, we submit that Pullman abstention is no more applicable in this case than the other branches abstention doctrine already discussed. Pullman "instructs 'that federal courts should abstain from decision when difficult and unsettled questions of state law must be resolved before a substantial constitutional question can be decided.'" United Services Automobile Ass'n, supra, 792 F.2d at 361, quoting Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 236 (1934).

In our view, just to state the doctrine is to refute its application to the instant case. This case does not turn on "difficult or unsettled questions of state Law," but is inextricably linked to Freehold's PURPA claim, which is a matter of exclusively federal interest.

## CONCLUSION

For the reasons stated herein, the Court should reverse the district court's decision that it was without jurisdiction to hear this case.

Respectfully submitted,

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July 1, 1994

# APPENDIX H

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

New York State Electric & Gas Corporation ) Docket No. EL95-28-000

ORDER DENYING PETITION FOR DECLARATORY ORDER

(Issued April 12, 1995)

## I. Introduction

On February 14, 1995, New York State Electric & Gas Corporation (NYSEG) filed a Petition fcr Declaratory Order, Complaint, and Request for Modification of Rates in Power Purchase Agreements Imposed Pursuant to the Public Utility Regulatory Policies Act of 1978 (Petition). NYSEG asserts that the rates it pays for power produced by two qualifying facilities (QFs) under contracts with Lockport Energy Associates, L.P. (Lockport) and Saranac Power Partners, L.P. (Saranac) exceed NYSEG's avoided costs and, therefore, violate Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA).[1]

As described further below, we: (a) find that the rates required under NYSEG's contracts with Lockport and

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1 16 U.S.C.A. § 824a-3 (West 1985 & Supp. 1994).

Saranac are consistent with the provisions of PURPA, and our implementing regulations; and (b) deny the various forms of relief requested by NYSEG.

## II. Background

### A. Statutory and Regulatory Background.

Section 210(a) of PURPA requires the Commission to prescribe rules to encourage cogeneration and small power production --including rules that require electric utilities to purchase electric energy generated by qualifying cogeneration and small power production facilities.[2] Section 210(b) also requires the Commission to issue rules that insure that the rates an electric utility pays a QF are just, reasonable, in the public interest and not discriminatory.[3] However, the Commission cannot prescribe a rule that provides for "a rate which exceeds the incremental cost to the electric utility of alternative electric energy."[4]

The Commission's regulations, in turn, require electric utilities to purchase the capacity and energy made available

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2 16 U.S.C. § 824a-3(a) (1988). Qualifying cogeneration and small power production facilities are those cogeneration and small power production facilities that meet certain specified criteria. See 16 U.S.C.A. §§ 796(17)-(18) (West 1985 & Supp. 1994); 18 C.F.R. Part 292 (1994).

3 16 U.S.C. § 824a-3(b) (1988).

4 Id. Section 210(d) of PURPA defines such incremental cost as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." 16 U.S.C. § 824a-3(d) (1988).

by a QF.[5] They also provide that the rates an electric utility pays a QF shall be just, reasonable, in the public interest and not discriminatory.[6] They further provide that none of the regulations "requires any electric utility to pay more than the avoided costs for purchases"[7] and that a rate for purchases from a QF, construction of which commenced on or after November 9, 1978, will be considered to be just, reasonable, in the public interest and not discriminatory "if the rate equals . . . avoided costs."[8] The regulations stipulate that rates may be based on a utility's avoided costs as calculated at the time the obligation is incurred,[9] and such 'rates will meet the statutory and regulatory standards even if they "differ from avoided costs at the time of delivery."[10]

Section 210(f) of PURPA requires each State regulatory authority to implement the Commission's rules,[11] and the Commission's regulations, in turn, similarly required

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5 18 C.F.R. § 292.303 (a) (1994).

6 18 C.F.R. § 292.304(a) (1) (1994).

7 18 C.F.R. § 292.304(a) (2) (1994). The Commission's regulations define avoided costs as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the [QF] . . ., such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b) (6) (1994).

8 18 C.F.R.§ 292.304(b) (2) (1994).

9 18 C.F.R. § 292.304(d) (2) (1994).

10 18 C.F.R. § 292.304(b) (5) (1994).

11 16 U.S.C. § 824a-3(f) (1988).

that each State regulatory authority implement the rules.[12] Section 210(h) of PURPA grants authority and prescribes procedures for Commission enforcement of the requirements of Section 210(f).[13]

For most facilities that are QFs, Section 210(e) of PURPA and the Commission's regulations further provide for exemptions from regulation under the Federal Power Act (FPA), the Public Utility Holding Company Act, and also under state law -- including rate regulation under the FPA and state law.[14] Rates for sales at wholesale by QFs are governed, as noted above, by PURPA.

B. Factual Background

Lockport owns and operates a 1994 MW cogeneration facility in Lockport, New York.[15] Lockport has a power purchase agreement with NYSEG, executed on March 26, 1990, pursuant to which NYSEG purchases the net electric output of the facility (less any power sold to

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12 18 C.F.R. § 292.401(a) (1992). Or May 1, 1992, the Commission eliminated this provision of its regulations as obsolete. The Commission explained that its QF rules took effect in 1980, and that State regulatory authorities and nonregulated electric utilities were required to implement those rules within one year or by the end of 1981. See Eliminating Unnecessary Regulation, Order No. 541, 57 Fed. Reg. 21,730 (May 22, 1992), III FERC Stats. & Regs. ¶ 30,943 at 30,495 (1992).

13 16 U.S.C. § 824a-3(h) (1988).

14 16 U.S.C.A. § 824a-3(e) (West 1985 & Supp. 1994); 18 C.F.R.§§ 292.601(c), 292.602(c)(i) (1994).

15 The Commission previously has certified the Lockport facility as a QF. See Empire Energy-Niagara Cogeneration, Inc., 45 FERC ¶ 61,241 (1988).

Lockport's steam host) for a term of fifteen years that commenced upon the facility's commercial operation in October 1992. Saranac owns and operates a 240 MW cogeneration facility in Plattsburgh, New York.[16]

Saranac entered into a power purchase agreement with NYSEG on April 27, 1990, pursuant to which NYSEG purchases the net electric output of the facility for a term of fifteen years that commenced upon the facility's commercial operation in June 1994.

The payment rates under both the Lockport and Saranac agreements are fixed for the terms of the agreements. The rates are based on the estimates of the New York State Public Service Commission'(New York Commission) of NYSEG's long-run avoided costs (LRACs), as calculated by the New York Commission in 1988.

C. NYSEG's Petition

In its Petition, NYSEG complains that the New York Commission required NYSEG to enter into the agreements with Lockport and Saranac despite NYSEG's objections that the agreements did not adequately protect NYSEG's ratepayers against the risk of payments in excess of avoided costs.[17] According to NYSEG, it has retained two independent analysts, each of which have considered new

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16 The Commission, acting pursuant to delegated authority, previously has certified the Saranac facility as a QF. See Saranac Energy Company, Inc., 57 FERC ¶ 62,211 (1991).

17 NYSEG apparently had proposed to the New York Commission that tracking and reconciliation provisions and other security measures be included in the agreements to avoid payments in excess of avoided costs if the LRAC estimates used to formulate the payment rates proved to be inaccurate. Petition at 12.

LRAC projections for NYSEG and now predict that payments under the Lockport and Saranac agreements will exceed NYSEG's avoided costs throughout the terms of those agreements.[18] Relying on these predictions, NYSEG argues that the rates under the agreements are unauthorized under PURPA.

Specifically, NYSEG seeks three forms of relief. First, pursuant to Rule 207(a)(2) of the Commission's Rules of Practice and Procedure,[19] NYSEG requests that the Commission issue a declaratory order finding that PURPA and the Commission's regulations prohibit, in the case of NYSEG's mandated power purchase agreements with Lockport and Saranac, purchase rates that: (a) are in excess of NYSEG's avoided cost; and (b) were based on New York Commission estimates of NYSEG's LRACs calculated at the time the agreements were mandated by the New York

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18 The two analysts retained by NYSEG are Energy Management Associates (EMA) and ICF Resources, Incorporated (ICF). EMA compared payments to be made under the agreements to LRAC estimates for NYSEG calculated by the New York Commission in October 1994. ICF used independent assumptions and made its own calculations of NYSEG's avoided costs. For the period from January 1, 1995 to the end of the term of each agreement, the analysts predict that payments under each agreement will exceed NYSEG's avoided costs in the following amounts:

| | Lockport Agreement | Saranac Agreement |
|---|---|---|
| EMA Prediction: | $784 million | $1.3 billion |
| ICF Prediction: | $580 million | $912 million |

Petition at 13-15.

19 18 C.F.R. § 385.207(a)(2) (1994).

Commission. NYSEG explains that it consistently challenged the purchase rates before the New York Commission as not adequately protecting NYSEG's ratepayers against the risk that the estimates of LRACs would prove to be overstated over the life of the mandated agreements. NYSEG also explains that the aggregate amount of overpayments to Lockport and Saranac in excess of its avoided cost (See supra fn. 18.) became evident only after NYSEG's time to appeal the orders of the New York Commission directing NYSEG to enter into those agreements had elapsed.

Second, pursuant to Rule 206(a) of the Commission's Rules of Practice and Procedure,[20] NYSEG requests that the Commission either take appropriate action itself under Section 210(b) of PURPA [21] or, under Section 210(h) of PURPA,[22] direct the New York Commission to relieve NYSEG of its obligation to make payments in excess of its avoided cost under the Lockport and Saranac agreements. Finally, NYSEG asks the Commission to make whatever revision or waiver of its rules is necessary to grant the requested relief.

In support of its request for relief, NYSEG states its belief that Section 210(b) of PURPA sets a rate ceiling for utility purchases from QFs at the utility's avoided cost of alternative energy. Because NYSEG predicts that the purchase rates in the Lockport and Saranac agreements will exceed this statutory limit, the rates are unlawful according to NYSEG.

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20 18 C.F.R. § 385.206(a) (1994).

21 16 U.S.C. § 824a-3(b) (1988).

22 16 U.S.C. § 824a-3(h) (1988).

NYSEG argues further that the Commission, by rulemaking implementing PURPA, may not except from PURPA's rate ceiling long-term fixed rates that exceed avoided costs over the term of an agreement. Instead, overestimations and underestimations of avoided costs must balance out so that there are no more than "short-term disparities" between estimates of avoided costs in a contract and the utility's actual avoided costs at the time energy is delivered. Moreover, NYSEG believes that the Commission must mandate that power purchase agreements contain protective measure's to ensure this result.

NYSEG asserts that Section 210 of PURPA "invests the Commission with plenary authority to take action insuring that purchase rates for QF energy comply with PURPA's statutory standards."[23] NYSEG believes this authority derives from the Commission's authority under PURPA to set rates for purchases from QFs and to insure State implementation of the Commission's regulations.

NYSEG also relies on the Commission's recent decision in Connecticut Light and Power Company[24] as precedent for granting the relief it requests. Recognizing that the fact pattern in Connecticut was different from that presented here, NYSEG, unlike the utility CL&P, could not have shown any discrepancy between its avoided costs and the contractual purchase rates at the time the New York Commission mandated the agreements with Lockport and Saranac.

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23 Petition at 41.

24 70 FERC ¶ 61,012 (1995) (Connecticut).

Finally, NYSEG makes the public policy arguments that: (a) the QF contracts at issue are not consensual agreements and, therefore, do not warrant the Commission's usual deference to private contracts; and (b) genuine competition would not require a party to purchase against its will power at rates in excess of market values.

Notice of NYSEG's Petition was published in the Federal Register,[25] with protests and motions to intervene originally due on or before March 7, 1995. By notice of the Commission issued on February 23, 1995, the intervention date was extended to March 14, 1995, with responses to interventions due on or before March 24, 1995.

D. Responses of Lockport and Saranac

On March 14, 1995, Lockport and Saranac each filed a motion to intervene and protest in response to NYSEG's Petition. Both Lockport and Saranac believe that the gravamen of NYSEG's Petition is its contention that the Commission's avoided cost regulations under PURPA -- especially the regulation (18 C.F.R. 292.304) that allows avoided cost to be calculated as of the date the obligation is incurred -- are illegal and should be revised and applied retroactively. Arguing that such regulatory changes cannot be accomplished without full notice and comment rulemaking, and that the Commission lacks jurisdiction to grant NYSEG's requested relief, Lockport and Saranac request that the Commission dismiss NYSEG's Petition. More specifically; Lockport and Saranac argue as follows.

Lockport contends that, for a number of reasons, the Commission has no legal authority to grant the relief requested by NYSEG. First, Lockport believes that the

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25 60 Fed. Reg. 9677 (1995).

Commission's enforcement power under Section 210(h) of PURPA is limited to ensuring that State regulatory authorities have implemented the Commission's regulations. Because NYSEG admits in its Petition that the New York Commission has properly implemented such regulations, Lockport asserts that there is no basis for the requested enforcement action. Second, Lockport points out that most QFs are exempted from both state and federal rate regulation under Section 210(e) of PURPA and the Commission's regulations.[26] Therefore, the Commission has no jurisdiction over the rates in Lockport's contract with NYSEG. Finally, Lockport maintains that, as the preamble to the Commission's QF regulations indicates, the Commission considered and rejected at the time its PURPA rules were issued the claim that power purchase rates must change contemporaneously with market circumstances. Lockport contends that NYSEG should have brought its complaint to the Commission at that time; because NYSEG failed to do so, its claim is now time-barred.

Assuming the Commission has the jurisdiction to grant NYSEG"s requested relief, Lockport argues that relief nevertheless should be denied. Lockport argues that NYSEG's allegations of changed market circumstances represent the type of justification the Commission has consistently found insufficient to support contract modification.[27] In further support, Lockport argues that: (1) it reasonably relied on the Commission's rules and the

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26 See 16 U.S.C.A. § 824a-3(e) (West 1985 & Supp. 1994); 18 C.F.R. §§ 292.601 and 292.602 (1994).

27 If the Commission grants NYSEG's request, Lockport believes the Commission will be inundated with utility filings claiming that current avoided cost projections differ from their contractual rates, the QF industry will be plunged into uncertainty, and competition will be undermined.

agreement with NYSEG in developing its project; and (2) NYSEG's conclusions regarding the relationship between the contractual purchase rates and its current avoided costs are fundamentally flawed.

Saranac argues that its contract with NYSEG violates neither the provisions of PURPA nor the Commission's implementing regulations. Saranac states that, consistent with PURPA and the implementing regulations, its rates were calculated at the time the obligation was incurred and set below NYSEG's avoided costs as projected by the New York Commission. Saranac believes that NYSEG's current avoided cost estimates are fundamentally flawed.

Saranac also argues that NYSEG's request for a declaratory order comes fifteen years too late. If NYSEG disagreed with the clear provisions of the Commission's regulations implementing PURPA, it should have contested those regulations when they were promulgated according to Saranac. Saranac asserts that NYSEG's claim that only now does it have sufficient evidence to appeal the regulations is hollow because other similarly situated parties were able to pursue such appeals at the time the regulations were promulgated, and the regulations ultimately were upheld by the United States Supreme Court. Saranac contends that NYSEG cannot now belatedly pursue such an appeal.

Like Lockport, Saranac argues that the Commission has no jurisdiction to grant the Section 210 enforcement requested by NYSEG. Saranac believes that such enforcement is limited to a State's failure to implement the Commission's regulations, and no such complaint is made by NYSEG.

Finally, as indicated above, Saranac points out that any revision of the Commission's regulations, such as that being requested by NYSEG, requires a full notice and

comment rulemaking, and any regulations resulting from such a procedure could be applied only prospectively. Saranac contends that this is the only process that would comport with Commission precedent regarding pre-existing contracts and the industty's appropriate reliance on the Commission's regulations.

E. Other Interventions

1. State and Governmental Entities

On March 14, 1995, the New York Commission filed a notice of intervention in support of NYSEG's Petition. The New York Commission complains that, because avoided cost estimates for NYSEG and other New York utilities have dropped since 1990, the purchase prices contained in the Lockport and Saranac agreements are a burden on NYSEG's ratepayers and have contributed to economic depression in NYSEG's service territory. Therefore, the New York Commission encourages the Commission to modify the exemption of the Lockport and Saranac facilities from rate regulation and revise the purchase rates contained in their contracts pursuant to Section 206(a) of the FPA.[28] The New York Commission believes these actions are appropriate because, after fifteen years of PURPA implementation and the resulting changes in the electricity industry, cogeneration and small power production no longer require incentives for development. In addition, the New York Commission asks the Commission to consider prospective modification of Lockport's and Saranac's gas supply contracts and to authorize, as a general matter, curtailment of utility purchases from QFs where (a) contract

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28 Lockport and Saranac, as QFs that do not fall within the exclusion set forth in 18 C.F.R. § 292.601(b), are exempt from Section 206 of the FPA. See 18 C.F.R. § 292.601(c).

prices exceed the utility's actual avoided costs, (b) the utility can demonstrate that the purchases would impose an undue and substantial burden on utility ratepayers, and (c) curtailment would not defeat the QF's financial viability.

The New York State Consumer Protection Board (New York Board) also intervened in support of NYSEG's Petition on March 14, 1995. The New York Board, which is charged with the statutory duty of representing the interests of consumers of the state before federal, state and local administrative and regulatory agencies,supports NYSEG's Petition on the basis that PURPA prohibits payments to QFs in excess of a utility's incremental costs. The New York Board believes that the rates contained in the Lockport and Saranac agreements inflate rates paid by NYSEG's consumers and contribute to the unfavorable economic environment in upstate New York.[29]

On March 30, 1995, the Pennsylvania Public Utility Commission (Pennsylvania Commission) filed a motion for late intervention raising no substantive issues.

Finally, the Secretary of the Department of Energy (DOE) filed a notice of late intervention on April 6, 1995. DOE is concerned that NYSEG's requested relief will undermine the successful contribution of PURPA,

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29 Although it did not formally intervene, the Town of Lockport Industrial Development Agency (Agency) submitted a letter to the Commission on March 13, 1995, supporting the Lockport facility's continued operation and noting that General Motors Corporation (GM), a major employer and important community member, relies on the facility (through purchases of steam and electricity) for the continued viability of its manufacturing plant. The Agency also expresses an inability to understand how NYSEG now can challenge a contract which NYSEG describes as being executed under the Commission's regulations as implemented by the New York Commission.

demonstrated over the last fifteen years, to our national energy policy. DOE believes that the Commission's regulations authorizing QF payments on the basis of long-term projections of avoided costs reflect a reasonable construction of Section 210(b) of PURPA, which does not provide direction on how or when to determine incremental cost. Most importantly, DOE emphasizes that a competitive electricity market cannot flourish without greater reliance on the integrity of contracts.

2. Cogenerators and Independent Power Producers

On March 10, 1995, the Independent Power Producers of New York, Inc. (IPPNY) filed a motion to intervene and protest. IPPNY is a not-for-profit trade association that represents more than 100 owners, operators, suppliers and financiers of QFs selling power in, or to utilities located in, the State of New York. IPPNY argues that the Lockport and Saranac contracts, containing purchase rates that were approved by the New York Commission as below NYSEG's avoided costs, are fully consistent with PURPA's mandates. IPPNY further argues that NYSEG, if it thought it had too much exposure to overpayments, should have sought judicial review in State court of the New York Commission's approval of the contracts. Its failure to do so, according to IPPNY, shows the reasonableness of the New York Commission's determinations. Finally, IPPNY urges the Commission to retain its policy, reaffirmed in recent precedent, of refusing to interfere with long-standing contracts. To do otherwise, according to IPPNY, would lead to countless lawsuits and financial losses for other QFs throughout the country.

Also on March 10, 1995, the Electric Generation Association (EGA) filed a motion to intervene and to dismiss NYSEG's Petition. EGA, a national trade association representing independent power producers, including owners

of QFs, and suppliers of gcods and services to the wholesale electric generation industry, focuses its argument on the detrimental impact that Commission intrusion into the sanctity of contracts would cause. EGA asserts that unilateral reformation of executed power purchase agreements would undermine the competitive environment, grounded in greater market discipline, which the Commission is trying to create. Moreover, unless existing utility obligations to purchase independent power at negotiated rates are honored, EGA contends that independent producers will suffer irreparable financial hardship and the progression to a competitive power market will not continue. Finally, EGA points out that the risks associated with the use of LRAC estimates fall equally on utilities and QF sellers, and that retrospective Commission review and analysis of avoided cost estimates is inconsistent with PURPA and the Commission's regulations.

The National Independent Energy Producers (NIEP), an association of companies that supply electricity for sale to utilities, filed a motion to intervene, protest and answer on March 14, 1995. NIEP argues that the Commission should reject NYSEG's Petition for four reasons. First, evaluation or modification of fixed rates in existing QF contracts is precluded under Section 210(e) of PURPA, which exempts most QFs from utility-type rate,regulation under the FPA. Second, NYSEG's untimely efforts to modify the Lockport and Saranac purchase rates are barred by the doctrines of collateral estoppel and laches. Third, the Commission and the courts do not allow retrospective application of changes to Commission policy if such retrospective application disrupts the settled expectations of those that relied on existing regulations. Finally, granting NYSEG's requested relief would mean that only utilities could rely upon long-term contracts, and the electricity market would return to its pre-PURPA status where utilities were virtually the only generation suppliers.

On March 14, 1995, both the Independent Energy Producers Association, Inc. (IEP) and the Cogeneration Association of California (CAC) filed motions to intervene. IEP is a non-profit trade organization representing 42 owners and operators of nonutility generating facilities In California. CAC is an ad hoc association whose members are cogeneration companies with QF projects and long-term contracts. Both IEP and CAC oppose NYSEG's Petition as an impermissible intrusion into the sanctity of contracts relied upon by QFs to obtain financing for their projects. IEP argues further that (a) the regulatory promise of PURPA and the Commission's regulations is that rates for QF sales need not change over time even if the utility's current avoided costs do change, and (b) modification of the Lockport and Saranac agreements is beyond the Commission's jurisdiction and would amount to retroactive application of a change in the Commission's regulations. IEP also points out that NYSEG proposes to treat its own resources that exceed current market prices differently from QF facilities, arguing that under the regulatory compact it should recover all costs associated with its nuclear and coal facilities but that QFs have no right to rely on existing contracts or prior regulatory commitments. According to IEP, there are 3,600 power purchase arrangements entered into throughout the country in reliance on the Commission's PURPA regulations. Finally, IEP asserts that the utilities would be the direct beneficiaries of the defaults and bankruptcies of independent facilities that would result from granting NYSEG's request, and that the ultimate losers from the demise of competition would be ratepayers.

On or before March 13, 1995, three owners and operators of cogeneration facilities moved to intervene: Binghamton Cogeneration Limited Partnership (Binghamton), Fulton Cogeneration Associates (Fulton) and Watson Cogeneration Company (Watson). Binghamton and Fulton

raise no substantive issues. Watson believes that the NYSEG Petition should be dismissed because (a) the Lockport and Saranac agreements are fully compatible with PURPA, (b) the Petition is untimely in its attack on regulations adopted in 1980, (c) NYSEG, relying only on further projections of avoided cost, has failed to prove any injury, and (d) granting NYSEG's request would disrupt other existing contracts, injuring the cogeneration and independent power industries.

Motions to intervene out-of-time were filed by (a) California Energy Company, Inc. (California Energy) and Magma Power Company (Magma) on March 15, 1995, (b) Indeck Energy Services, Inc. (Indeck) on March 20, 1995, (c) Cogen Technologies, Inc. (Cogen) on March 24, 1995, and (d) Kamine/Besicorp Allegany L.P. (Kamine/Besicorp) on March 29, 1995. Kamine/Besicorp explains that it operates a QF from which electricity is sold to Rochester Gas and Electric Corporation (RG&E) pursuant to a long-term power purchase agreement executed in reliance on PURPA and the Commission's implementing regulations. Kamine/Besicorp supports the arguments made by Saranac and the National Power Lenders Forum (the Forum) in their motions to intervene.[30]

Cogen, through its affiliates, is an investor, developer and operator of a number of QFs, one of which sells power to Consolidated Edison Company of New York, Inc. (ConEd) pursuant to a long-term contract approved by the New York Commission. Cogen argues that NYSEG's Petition should be summarily denied for the same reasons asserted in interventions by other independent power producers. Indeck, through affiliates, owns QFs that sell

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30 The Forum's motion to intervene is described further below. See infra pp. 14-15.

electric energy and capacity under long-term power purchase agreements to NYSEG, ConEd and Niagara Mohawk Power Corporation (Niagara Mohawk). Indeck protests NYSEG's Petition, is concerned that ConEd and the New York Commission have sought to expand this proceeding to request broad-scope Commission interference in long-term. cortracts, and supports the arguments made by IPPNY.

California Energy and Magma own, operate and develop QFs and other independent power production facilities. They are concerned that NYSEG's Petition could adversely impact their QF contracts executed pursuant to PURPA and their ability to obtain financing for future development. California Energy and Magma make further arguments similar to those made by other independent producers about the Commission's jurisdiction in this proceeding and the Lockport and Saranac agreements' compliance with PURPA.

Finally, motions to intervene out-of-time were filed by Warbasse-Cogeneration Technologies Partners, L.P. (Warbasse) on April 7, 1995, and Brooklyn Navy Yard Cogeneration Partners, L.P. (BNYCP) on April 10, 1994, both of which note that the New York Commission's intervention raises generic issues that could affect all QF contracts. Warbasse owns and operates a QF from which it sells electricity to ConEd. BNYCP is developing a cogeneration project that will sell electricity to ConEd at rates based upon winning bids in ConEd's all-source bidding program.

3. Natural Gas Companies

On March 14, 199S, Aquila Energy Marketing Corporation (Aquila) filed a motion to intervene and protest. Aquila is a natural gas marketing company that supplies a portion of the natural gas requirements of the Lockport facility. Aquila argues that the NYSEG Petition should be dismissed because NYSEG failed properly to challenge the Commission's implementing rules and the New York Commission's avoided cost determinations and orders concerning the agreements. Aquila states that all the parties involved with the Lockport project, including the fuel suppliers, have relied upon the executed and approved Lockport power purchase agreement in entering into their own agreements, the obligations of which depend upcn the continued performance of NYSEG and Lockport under the Lockport agreement.

North American Resources Company (NARCO), another supplier of natural gas to the Lockport facility, filed a motion to intervene and protest on March 15, 1995. NARCO requests that the NYSEG Petition be dismissed as a collateral attack on the Commission's regulations and the final order of the New York Commission. NARCO insists that (a) as recognized in the NYSEG Petition, determining the basis for permissible rates in longterm contracts is fully within the Commission's discretion and (b) to the extent that balancing interests is appropriate in this proceeding, the Commission must consider all the relationships that were entered into in reliance on the Lockport agreement.

On March 14, 1995, TransCanada Pipelines Limited (TransCanada) filed a motion to intervene and protest opposing NYSEG's Petition. TransCanada, a provider of firm natural gas transportation services to Saranac and NYSEG, states that it made significant expansions to, and investments in, its infrastructure to service the non-utility

generating industry in New York in reliance on contracts such as that between Saranac and NYSEG. Moreover, TransCanada explains, the National Energy Board of Canada similarly relied on such contracts in approving the expansions.

The Canadian Association of Petroleum Producers (CAPP) also filed a motion to intervene and protest on March 14, 1995. CAPP is an industry trade association representing 194 Canadian oil and gas producers that supply fuel to existing and potential future cogeneration projects. CAPP asks the Commission to deny the relief requested by NYSEG because it would damage the economics of existing independent power projects and jeopardize the financeability and chill the development of future projects. Further, CAPP requests that the Commission establish (a) a hearing proceeding in the event that it considers relieving NYSEG of its contractual obligations and (b) a formal rulemaking proceeding in the event the Commission considers modifying its implementing regulations.

ProGas Limited (ProGas), a natural gas supplier to Lockport, filed a motion to intervene on March 14, 1995, raising no substantive issues.

4. Public Utilities

On or before March 14, 1995, Atlantic City Electric Company (Atlantic), Central Maine Power Corporation (Central Maine), ConEd, Long Island Lighting Company (LILCO), Niagara Mohawk and RG&E each filed separate motions to intervene in this proceeding. These utilities each state that they have contracts with QFs that exceed their avoided costs and, therefore, will be impacted in their ability to seek relief fiom these high-cost contracts by the outcome of this proceeding. Central Maine argues further that (a) the prospect of numerous claims similar to NYSEG's is not a

reasonable basis for the Commission to decline to act in this matter and (b) QFs' rights under contract law should not take precedence over other parties' interests. Niagara Mohawk asserts that (a) experience has proven erroneous the Commission's expectation that overestimations and underestimations of avoided cost will balance out in the long run, and (b) mandated QF agreements are inconsistent with a competitive wholesale electric market, particularly in states like New York where past regulatory policies have been flawed.

5. Other Organizations and Corporations

On March 14, 1995, the National Power Lenders Forum (the Forum) filed a motion to intervene and protest. The Forum is an informal association of major domestic and international financial institutions whose members have significant outstanding loans to, or other substantial investments in, electric generating facilities that sell power to utilities in New York and other states pursuant to long-term agreements.[31] The Forum explains that the loans it provides QFs are highly structured project financing arrangements that rely on a steady flow of revenues to projects under power sale contracts similar to those of Lockport and Saranac. It further explains that the policy of respecting sanctity of contracts allows contracts to be used to allocate risk, on an enforceable basis, among parties to a transaction. Any effort

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31 Financial institutions participating in the Forum are ABNAMRO Bank, N.V., CIGNA Investments, Inc., Credit Suisse, General Electric Capital Corp., John Hancock Mutual Life Insurance Co., Mellon Bank, N.A., National Westminster Bank Plc, The Prudential Insurance Company of America and Swiss Bank Corporation. Some members are lenders to the Lockport and Saranac projects. The members' aggregate loans to QFs exceed $11.5 billion.and Saranac projects. The members' aggregate loans to QFs exceed $11.5 billion.

by the Commission to revise this policy to allow invasion of existing contracts, the Forum argues, would (a) cause lenders and investors to lose confidence in their ability to assess investment risk on the basis of contracts within the Commission's reach, (b) undermine the essential support for the capital structure of the QF industry, (c) impair the ability of banks and institutional lenders to finance the electric services industry on reasonable and relatively low-cost terms, and (d) threaten the existence of future competition in the industry. The Forum also argues that purchase rates in executed and approved QF contracts are exempt from federal and state regulation, the prices in the Lockport and Saranac agreements are consistent with Section 210 of PURPA and the Commission's implementing regulations, and NYSEG's Petition requests impermissible retroactive rulemaking. Finally, the Forum contends that uncompensated reductions in the prices for electricity under the Lockport and Saranac agreements would constitute a taking in violation of the United States Constitution, and, if such reductions were instituted by the New York Commission, would violate the Contract Clause of the Constitution.

Also on March 14, 1995, GM filed a protest and motion to intervene. Through one of its divisions, GM operates a manufacturing plant in Lockport, New York, that consumes steam and electric energy produced by the Lockport facility. GM believes that the relief requested by NYSEG would endanger the economic viability of the Lockport facility and, therefore, its manufacturing plant which, due to energy savings afforded by the Lockport facility, has increased production and received relocated operations previously conducted outside the United States. GM points out that, in a more competitive electricity marketplace, all parties will rely less on traditional rate regulation and more on contractual arrangements. Similarly, industrial and commercial customers, who make critical resource decisions in reliance on contractual terms, will

require contractual certainty to compete effectively. GM argues that NYSEG's request to modify purchase rates in the Lockport agreement improperly challenges the lawful avoided cost determination of the New York Commission and, because Lockport is a QF exempt from utility-type rate regulation, is beyond the Commission's rate jurisdiction.

Finally, the American Forest and Paper Association (AFPA), an association of the forestry, pulp, paper, paperboard and wood products industry, filed a motion to intervene and protest on March 14, 1995. AFPA's members hold sizable manufacturing interests in New York, represent in the aggregate the third largest industrial purchaser of electricity from utilities in the United States, and engage in significant self-generation and cogeneration of electric power. AFPA opposes NYSEG's Petition as a collateral attack on the Commission's PURPA regulations and a threat to major investment commitments made by its members in reliance on these regulations and the availability of purchased steam from third-party generators. AFPA states that, if the Commission allows executed contracts to be disturbed, its members may lose both their generating plants and their paper plants.

F. Responses to Interventions

1. NYSEG

On March 22, 1995, NYSEG filed a reply to the pleadings that responded to NYSEG's Petition. NYSEG reiterates the legal arguments made in its Petition and rebuts the arguments of Lockport, Saranac and those intervening in their support as follows. First, NYSEG asserts that the Commission has statutory authority to grant the requested relief because Congress cannot have intended to leave the Commission powerless to remedy perceived violations of PURPA's avoided cost rate standard. Second, NYSEG

argues that the Lockport and Saranac contracts are not consensual agreements deserving of particular deference. Third, an order granting NYSEG's Petition will aid the competitive market, according to NYSEG, because it will stop the payment of subsidies to competitors. Finally, NYSEG asserts that its Petition presents no timing issues because it was filed at the time NYSEG became aware of the gap between its avoided costs and the contract rates, the Commission has never before addressed whether PURPA permits a permanent divergence from avoided cost, and NYSEG seeks only prospective modification of the mandated rates.

2. Lockport and Saranac

On March 24 1995, Lockport filed a response to the intervention of the New York Commission, taking issue with the position of the New York Commission in three ways. First, Lockport asserts that the curtailment of QF purchases requested by the New York Commission would violate this Commission's regulations generally and the amendment to the Lockport contract, voluntarily negotiated and executed by NYSEG in October 1994, waiving NYSEG's right to any further curtailment of the Lockport project, specifically. Second, Lockport argues that the Commission has no jurisdiction to decide whether to encourage cogeneration; Congress has mandated such encouragement through the provisions of PURPA. Finally, Lockport describes the New York Commission's substantial involvement in the negotiation and approval of the Lockport and Saranac contracts and expresses concern that the New York Commission's unwillingness to support its actions will impair the viability of the competitive power market in New York State.

Saranac also filed a response to the New York Commission's intervention on March 24, 1995. Saranac

points out that the New York Commission relies solely on (a) the difference between NYSEG's current LRAC projections and the Lockport and Saranac purchase rates and (b) the economic depression in NYSEG's service territory for its request that this Commission disavow its regulations, overturn the New York Commission's orders, unilaterally revise Saranac's power-purchase agreement and gas supply contract, and permit curtailment of QF purchases for economic reasons. Saranac believes it is important to remember that the New York Commission, as a condition of approving the Saranac power purchase agreement, required Saranac to enter into a fixed-price, long-term fuel supply agreement to protect ratepayers from higher fuel prices. Saranac further contends that, because 100 percent of NYSEG's own generation, 90 percent of NYSEG's power purchases, and 100 percent of investor-owned utility generation in New York State exceed the avoided cost of 2.71¢ per kWh currently asserted by NYSEG, the New York Commission should be addressing rates for New York utility generation over which it has jurisdiction.

3. New York Commission

The New York Commission filed reply comments on March 24, 1995, to address the potential economic impact on Lockport and Saranac of the requested relief. The New York Commission states that it (a) would not support price reductions that would drive independent producers into bankruptcy, (b) does not believe that reducing the Lockport and Saranac prices would defeat the financial viability of these projects, and (c) believes that the requested relief would not have a deleterious effect on the independent power industry.

4. Cogenerators and Independent Power Producers

On March 24 1995, IPPNY filed an answer opposing the arguments raised by the New York Commission. IPPNY objects to the New York Commission's apparent reversal of its long-standing policy supporting long-term, fixed-price contracts. IPPNY believes that the New York Commission has ignored a number of essential issues in adopting this new position: (a) the New,York Commission's own role in NYSEG's high rates, (b) the financial impact on the independent power industry which has invested $10 billion in New York State in reliance on the New York commission's policy, (c) the impact on the viability of QFs' steam hosts, (d) the New York Commission's unquestioning acceptance of NYSEG's estimates of "overpayments" when such estimates have been subject to dispute proceedings, (e) the necessity of pricing NYSEG's own resources based on its LRAC estimates, (f) the numerous factors which have harmed the economic climate not only in NYSEG's service territory, but in the entire State of New York, and (g) the absence of any legal basis for the New York Commission's requests.

Also on March 24, 1995, EGA and NIEP each filed a response to the New York Commission's intervention. EGA objects to the New York Commission's request for revision of this Commission's regulations to allow regulation of the Lockport and Saranac contract prices. EGA believes that such revision would (a) constitute an action of generic applicability that, without notice and comment rulemaking, violates Administrative Procedure Act requirements, (b) be inconsistent with PURPA's goal of encouraging QF development, (c) inadvisably overturn Commission policies regarding contract reliance, and (d) prevent contracting parties from allocating market risks between themselves. NIEP asks the Commission to reject the New York

Commission's requests for the same reasons described in NIEP's protest.

5. Other Parties

ProGas filed a response to the New York Commission's intervention on March 24, 1995. ProGas argues that its gas supply contract with Lockport: (a) is, by reference to NYSEG's Petition, not at issue in this proceeding, and (b) has been approved by the Department of Energy's Office of Fossil Energy and, therefore, is beyond the Commission's jurisdiction.

On March 24, 1995, the Forum answered the interventions of the New York Commission and the New York Board. The Forum believes that the New York Commission and the New York Board incorrectly fault QFs for economic difficulties in New York. The Forum explains that job losses since 1988 and unemployment for 1994 cannot be blamed on two individual generation projects that began operation in 1992 and 1994. Moreover, the Forum asserts that the positive economic impacts of the independent power industry are not being considered and will be harmed if the New York Commission's requests are granted. The Forum urges the Commission to deny the New York Commission's curtailment request because, constituting a rule of general applicability, it is inappropriately raised in this proceeding, and it is inconsistent with PURPA and Section 292.304(f) of the Commission's regulations.[32] Finally, the Forum asserts that the New York Commission's short-term focus on rates, in lieu of a longer-range and broader view of economic benefits to commerce and ratepayers, indicates that this Commission should not leave implementation of PURPA to the states.

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32 18 C.F.R. § 292.304(f) (1994).

Niagara Mohawk filed a reply to the interventions of NIEP and the Forum on March 24, 1995. Niagara Mohawk argues that, contrary to the Forum's claims, governmentally-mandated power purchase agreements lack mutual assent and, therefore, do not warrant the same Constitutional protections as contracts freely entered into. NIEP and the Forum are also wrong in asserting that the Commission has no jurisdiction over the Lockport and Saranac rates, according to Niagara Mohawk. Rather, Niagara Mohawk believes that Section 210(b) of PURPA requires the Commission to insure that QF rates meet statutory standards, and the Commission must address any violations of such standards that arise from changed circumstances.

Finally, on March 24, 199E, ConEd replied generally to the pleadings filed in this proceeding. ConEd believes that the Commission's recent decision in CGE Fulton, L.L.C.[33] stands for the proposition that a utility cannot be required, under a QF agreement, ultimately to pay a rate in excess of its avoided cost. ConEd thinks this conclusion should apply to NYSEG even though, unlike the situation in Fulton, the Lockport and Saranac rates were not facially invalid at the time the agreements were executed.

## III. Discussion

### A. Procedural Matters

Under Rule 214 of the Commission's Rules of Practice and Procedure,[34] the notices of intervention of DOE and the New York Commission and the timely,

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33 70 FERC ¶ 61,290 (1995) (Fulton).

34 18 C.F.R. § 385.214 (1994).

unopposed motions to intervene of Lockport, Saranac, the New York Board, IPPNY, EGA, NIEP, IEP, CAC, Binghamton, Fulton, Watson, Aquila, TransCanada, CAPP, ProGas, Atlantic, Central Maine, ConEd, LILCO, Niagara Mohawk, RG&E, the Forum, GM and AFPA serve to make them parties to this proceeding. In addition, we will grant the untimely motions to intervene of the Pennsylvania Commission, NARCO, Indeck, Cogen, Kamine/Besicorp, California Energy and Magma, Warbasse and BNYCP. We find that these interventions will not cause any undue prejudice or delay and that these parties have a sufficient interest in the outcome of this proceeding. Further, in light of the important issues raised, and in order to complete the arguments of all of the parties, we will consider (and thus not reject) all responsive pleadings filed in this proceeding.

B. NYSEG's Reauests for Relief

We will deny NYSEG's requests for relief. The Commission's regulations implementing PURPA do not prohibit rates for purchases from QFs that (1) are based on estimates of a utility's avoided costs calculated at the time the obligation is incurred and (2) subsequently differ from the utility's actual avoided costs at the time of delivery. Moreover, as we indicated in two recent orders, and as we explain further below, we will not disturb existing QF contracts containing such purchase rates if the contracts were not challenged at the time they were signed and are not now the subject of an ongoing challenge to the State's avoided cost determination.[35] NYSEG has presented no legitimate reason for us to depart from the holdings of these orders in this regard-and to upset long-term contracts with Lockport and

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35 Southern California Edison Company and San Diego Gas & Electric Company, 70 FERC ¶ 61,215 at 61,678 (1995) (California); Connecticut, 70 FERC at 61,029.

Saranac which were the basis for the financing and construction of the QF projects and under which the parties have been providing and paying for service.

Because NYSEG focuses its arguments on the Commission's regulations implementing PURPA, we take this opportunity to explain the import of, and the underlying reasons for, these regulations. The regulations specifically allow rates for the purchase of QF energy or capacity pursuant to a contract over a specified term to be based on avoided costs calculated, at the option of the QF, at the time of delivery or at the time the obligation is incurred.[36] Furthermore, the regulations make clear that, if rates are based on avoided cost estimates at the time the obligation is incurred, the rates are consistent with PURPA's requirements even if they differ from avoided costs at the time of delivery:

> In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.[37]

At the time these regulations were promulgated, the commission anticipated that avoided costs could change over time and balanced the relevant competing interests. The

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36 18 C.F.R. § 292.304(d)(2) (1994); see supra p. 2.

37 18 C.F.R. § 292.304(b)(5) (1994).

Commission intended the regulations described above "to reconcile the requirement that the rates for purchases equal the utilities' avoided cost with the need for [QFs] to be able to enter into contractual commitments based, by necessity, on estimates of future avoided costs."[38] The Commission recognized that, if the avoided cost of energy at the time it is delivered is less than the price provided in the contract, a utility may be required to pay a rate for purchases that would subsidize the QF at the expense of the utility's other ratepayers. However, the Commission also was:

> cognizant that in other cases, the required rate will turn out to be lower than the avoided costs at the time of purchase. The Commission does not believe that the reference in the statute to incremental cost of alternative energy was intended to require a minute-by-minute evaluation of costs which would be checked against rates established in long term contracts between [QFs] and electric utilities.

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38 Small Power Production and Cogeneration Facilities; Regulations Implementing Section 210 of [PURPA], Order No. 69, 45 Fed. Reg. 12,214, 12,224 (Feb. 5, 1980), FERC Stats. & Regs., Regulations Preambles 1977-1981 ¶ 30,128 at 30,880 (1980), order on reh'g, FERC Stats. & Regs., Regulations Preambles 1977-1981 ¶ 30,160 (1980), aff'd in part and vacated in part, American Electric Power Service Corporation v. FERC, 675 F.2d 1226 (D.C. Cir. 1982), rev'd in part, American Paper Institute, Inc. v. American Electric Power Service Corporation, 461 U.S. 402 (1983).

> Many commenters have stressed the need for certainty with regard to return on investment in new technologies. The Commission agrees with these latter arguments, and believes that, in the long run, "overestimations" and "underestimations" will balance out . . . . The import of this section [Section 292.304(b)(5) quoted above] is to ensure that a [QF] which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances. This provision can also work to preserve the bargain entered into by the electric utility.[39]

It is now far too late in the Commission's implementation of PURPA for NYSEG to argue, for the first time, that these particular regulations have legal and policy flaws requiring that we abrogate contracts entered into under these regulations.

In addition to being consistent with our regulations, the answer we give NYSEG herein is consistent with our practice of relying on the states to make factual determinations of utilities, avoided costs. As we recently stated in our

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39 Id.

California order, we have not been willing in the past, and do not intend in the future,

> to second-guess state regulatory authorities' actual determinations of avoided costs. . . . Rather, the Commission believes its role is limited to ensuring the process used to calculate the per unit charge (i.e., implementation) accords with [PURPA] and our regulations.[40]

As Lockport and Saranac correctly recognize, NYSEG raises no charge in this proceeding that the New York Commission failed to implement properly the Commission's PURPA regulations. In fact, NYSEG states to the contrary:

> In ordering NYSEG to accept the terms of the Lockport and Saranac agreements, the New York Commission was carrying out its statutory mandate under Section 210(f) of PURPA to implement the Commission's rules . . . grant[ing] the states broad authority to determine the

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40 California, 70 FERC at 61,677. See also, Connecticut, 70 FERC at 61,029; LG&E-Westmoreland Hopewell, 62 FERC ¶ 61,098 at 61,712 (1993); American REF-FUEL Company of Hempstead, 47 FERC ¶ 61,161 at 61,533 (1989).

specific parameters of QF power purchase agreements.[41]

Moreover, NYSEG explains how the New York Commission, at the time it mandated the Lockport and Saranac contracts, specifically addressed and accounted for the risk of harm which NYSEG now asserts. Instead of requiring protective mechanisms such as tracking and reconciliation provisions as it had in other cases, the New York Commission chose to account for any potential risk by applying a discount to the applicable LRAC estimates that formed the basis for purchase rates contained in the Lockport and Saranac agreements.[42]

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41 Petition at 37-38. In this regard, the instant proceeding is very much unlike the recent Connecticut and California proceedings, in which the applications directly challenged the States' implementation of the Commission's PURPA regulations. Here, unlike in Connecticut and California, the request for relief is based on a direct challenge to this Commission's implementation of PURPA specifically, the Commission's regulations (in 18 C.F.R. 292.304) that allow rates in QF contracts to be based on a utility's avoided costs as calculated at the time the purchase obligation is incurred, even if such rates ultimately differ from avoided costs at the time of delivery.

42 Petition at 12, 38-39. The Commission understands that these discounts were not insubstantial. In its order approving the Saranac agreement, the New York Commission noted that the fixed pricing schedule contained therein was similar to the recently-approved Lockport agreement and stated:

> While reconciliation mechanisms reduce ratepayer risk, and so permit approval of a contract upon a lesser discount than that needed to justify an unreconciled fixed-rate schedule, the 7.4% discount [from the New York Commission's 1988 LRACs applicable to NYSEG] . . . is sufficient to warrant approval of [the Saranac agreement] without reconciliation. This discount .

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This case is distinguishable from the recent Connecticut decision. In Connecticut, we found that the rates for purchases from the QF in that case, as a legal matter, may have exceeded avoided costs at the time the rates were imposed, a situation we determined would be in violation of Section 210(b) of PURPA.[43] Here, in contrast, the contracts at issue reflect State implementation consistent with PURPA and our regulations.
Accordingly, we will not disturb them.

A second, independent basis for denying NYSEG's Petition is the Commission's policy against invalidating contracts for which a PURPA-based challenge was not raised timely and is not still pending. Our position with respect to executed, unchallenged QF contracts was recently articulated in both the Connecticut and California cases, and we see no reason to diverge from this position, as requested by NYSEG.

NYSEG's reliance on our decision in the recent Connecticut case as precedent for the requested relief is misplaced. We held in the Connecticut order that a State statute that mandates rates for sales by QFs that exceed

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> . . exceeds the discounts provided under most reconciled contracts.

Petition at 12-131 quoting the New York Commission, Case Nos. 90-E-0867, 90-E-0865 and 90-E-0860 - Order Approving Contracts Subject to Conditions, March 5, 1991.

43 Similarly, in the California proceeding, the Commission addressed State-imposed rates for QF purchases, which failed to account for all available sources of capacity, prior to execution of the QF contracts (and assumption of purchase obligations).

avoided costs is preempted by PURPA.[44] We were aware that, should the appropriate State forum determine that the statute in question did require rates above avoided cost as a matter of fact, our legal conclusion in that case might affect an existing QF contract. However, this result was appropriate in Connecticut "because [the utility in Connecticut] has been challenging this rate since at least 1987,"[45] when the Connecticut Department of Public Utility Control ordered the utility to buy power at the disputed rates.

Similar facts are not alleged here. At the time the Lockport and Saranac agreements were executed, the purchase rates, according to New York Commission calculations, were below NYSEG's avoided costs. NYSEG, believing it had "neither a cognizable injury nor a basis to complain further to the New York Commission or to the Commission," chose not to appeal the New York Commission's orders mandating the agreements.[46] In both California and Connecticut, we affirmed again our general unwillingness to disrupt existing contracts under these circumstances:

> We believe that the appropriate time in which to challenge a state-imposed rate for a QF purchase is up to the time the purchase contract is

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44 Connecticut, 70 FERC at 61,029 and 61,031.

45 Id. at 61,029.

46 Petition at 3-5, 17, 47.

signed, not years into a contract.[47]

In this case, Lockport and Saranac (and their investors) invested in these projects in the reasonable belief that, once the deadline for timely challenges had passed, their contracts with NYSEG were lawful and binding under PURPA. We note that utilities have been quick to defend, and properly so, their right to recover legitimate, prudent and verifiable "stranded costs," based on claims that such costs are the product of settled and reasonable investor expectation.[48] The same principle applies to the investors in QF projects.

Moreover, as approved by the New York Commission, the contracts at issue allocated risks to both the purchaser and the sellers. Like NYSEG, Lockport and Saranac bore risks that their agreements would become uneconomic over time. QFs bear development risks not experienced to the same extent by traditional utilities.[49] As

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47 California, 70 FERC at 61,678. See also, Connecticut, 70 FERC at 61,029.

48 See Notice of Proposed Rulemaking and Supplemental Notice of Proposed Rulemaking, Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 70 FERC ¶ 61,357 (1995), slip op. at 154-55.

49 The Conference Report on PURPA explained as follows:

> [C]ogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis a vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.

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a result, they must rely on their power purchase agreements to obtain project financing, and we have ecognized the importance of contractual reliance for this purpose.[50] If we were to grant the relief requested by NYSEG and allow the reopening of QF contracts that had not been challenged at the time of their execution, financeability of such projects would be severely hampered. Such result is not, in our opinion, consistent with Congress' directive that we encourage the development of QFs.

As wholesale markets become more competitive, respecting contracts becomes increasingly important. Industry participants (and their investors) will rely more heavily on contractual, instead of regulatory, protection.[51] If financing generation becomes more difficult or even impossible because contracts are not respected, wholesale

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> Joint Explanatory Statement of the Conference Committee, Conf. Rep. No. 1750, 95th Cong., 2d Sess. 89, 1979 U.S.C.C.A.N. 7797.

50 As the Commission explained in the preamble, to its regulations implementing PURPA:

> > [I]n order to be able to evaluate the financial feasibility of a cogeneration or small power production facility, an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction of a facility.
>
> FERC Stats. & Regs., Regulations Preambles 1977-1981 at 30,868.

51 At times, the Commission must modify contracts pursuant to its responsibilities under the FPA. Still, the Commission does not exercise this authority lightly and strives to uphold the public policy of respecting contracts.

competition will diminish. This result would be contrary to this Commission's goals and to the Congressional intent expressed in the Energy Policy Act of 1992.[52]

The Commission orders:

(A) The untimely motions to intervene of the Pennsylvania Commission, NARCO, Indeck, Cogen, Kamine/Besicorp, and California Energy and Magma are hereby granted.

(B) The relief requested in NYSEG's Petition is hereby denied as discussed in the body of this order.

By the Commission.

(SEAL)

Lois D. Cashell,
Secretary.

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52 Pub. L. No. 102-486, 106 Stat. 2776 (1992).

# APPENDIX I

UNITED STATES OF AMERICA

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F.
Santa, Jr.

West Penn Power Company ) Docket No. EL95-30-000

ORDER DENYING PETITION FOR
DECLARATORY ORDER

(Issued May 8, 1995)

On March 10, 1995, West Penn Power Company (West Penn) filed a Petition for Issuance of a Declaratory Order (West Penn Petition). West Penn seeks a declaration by the Commission that certain actions by the Pennsylvania Public Utility Commission (Pennsylvania Commission) and Washington Power Company, L.P. (Washington Power) violate section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA)[1] and this Commission's implementing regulations. Specifically, West Penn argues that under federal law: (a) an electric utility cannot required to purchase capacity from a qualifying facility (QF)[2] at rates that exceed the utility's current avoided costs; (b) a State regulatory authority may not modify a power purchase agreement privately negotiated between an electric utility and QF or,

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1 16 U.S.C.A. § 824a-3 (West 1985 & Supp. 1995).

2 A QF is a cogeneration or small power production facility that meets certain specified criteria, primarily relating t technical aspects and ownership, under PURPA and our implementing regulations. See 16 U.S.C.A. §§ 796(17)-(18) (West 1985 & Supp. 1995); 18 C.F.R. Part 292 (1994). If all of the relevant statutory and regulatory criteria are satisfied, a QF may be both a qualifying cogeneration facility and a qualifying small power production facility. See id.

alternatively, avoided costs must be recalculated as of the time of such modification; and (c) avoided costs must be recalculated if a QF seeks certification of a new project design Finally, West Penn requests a determination that it has no current obligation to purchase capacity and energy from Washington Power's QF.

As described below, we deny West Penn's petition for declaratory order. The Pennsylvania Commission, and the courts, have determined that a valid, legally binding contract exists in this case. We will not disturb that contract. However, we would encourage the parties to the contract to consider settling their differences at this stage particularly if, as may be the case, the facility has not been constructed.

## I. Background

### A. Statutory and Regulatory Background

We have had occasion in several recent cases to summarize the basic components of section 210 of PURPA and our implementing regulations.[3] There are several provisions, discussed below, that are pertinent to the issues raised in this proceeding.

Under PURPA and our implementing regulations, the rates at which an electric utility is required to purchase a QF's capacity and energy may not exceed the utility's

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3 See, e.g., New York State Electric & Gas Corp., 71 FERC ¶ 61,027 (1995) (NYSEG), slip op. at 1-3; Southern California Edison Co., 70 FERC ¶ 61,215 at 61,676-77 (1995) (Southern California Edison); Connecticut Light & Power Co., 70 FERC ¶ 61,012 at 61,023-24, reconsideration denied, 71 FERC ¶ 61,012 (1995), appeal docketed sub nom. Niagara Mohawk Power Corp. v. FERC, No. 95-1222 (D.C. Cir. Apr. 24, 1995) (Connecticut Power).

avoided costs.[4] Our regulations expressly provide, however, that if the QF is providing energy or capacity "pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term," the rates may be based (at the QF's election) on the purchasing utility's "avoided costs calculated at the time the obligation is incurred."[5] Moreover, the regulations further stipulate that rates calculated as of such time will meet the statutory and regulatory standards even if they "differ from avoided costs at the time of delivery."[6] Finally, for most QFs, section 210(e) of PURPA and the Commission's regulations provide for exemptions from regulation under the Federal Power Act (FPA), the Public Utility Holding Company Act and state law--including exemptions from utility-type rate regulation under the FPA and under state law.[7]

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4 See 16 U.S.C. § 824a-3(b) (1988); 18 C.F.R. § 292.304 (a) (2) (1994).

5 18 C.F.R. § 292.304(d)(2) (1994).

6 18 C. F. R. § 292.304 (b) (5) (1994) .

7 16 U.S.C.A. § 824a-3(e) (West 1985 & Supp. 1995); 18 C.F.R. §§ 292.601(c), 292-602(c)(i) (1994).

B. Factual-Background[8]

Washington Power is building a cogeneration and small power production QF located near Burgettstown, Pennsylvania (Facility).[9] On October 15, 1987, after more than one year of negotiations, West Penn and Washington Power entered into an Electric Energy Purchase Agreement (Purchase Agreement) for sale of the capacity and energy of the Facility to West Penn.[10] The Purchase Agreement is for a 33-year term and originally contemplated that sales of capacity and energy from the Facility to West Penn would commence on October 1, 1991 (but also included provisions addressing the parties, rights and obligations in the event of later commencement dates). The rates are comprised of various components, including a capacity cost originally set at $0.036 per kilowatt (kW) hour, which was below West Penn's avoided costs calculated as of October 1986.[11]

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8 Our description of the factual background is derived primarily from the West Penn Petition, the Protest and Request for Dismissal of Washington Power, filed April 3, 1995 (Washington Power Protest), and the Protest and Motion to Dismiss of the Pennsylvania Commission, also filed April 3, 1995 (Pennsylvania Commission Protest). The relevant facts, particularly as to the extensive litigation that has preceded the filing of the West Penn Petition, are lengthy and convoluted but for the most part are not in dispute. We set forth the factual background prior to summarizing the pleadings, because we believe that acquaintance with the long-running prologue to the instant proceeding is essential to understanding the parties, positions here.

9 In North Branch Energy Partners, L.P. 42 FERC ¶ 62,240 (1988) (Cogeneration Certification), the Commission certified the Facility as a qualifying cogeneration facility. In Washington Power Co., L.P., 69 FERC 62,119 (1994) (Small Power Production Certification), the Commission also certified the facility as a small power production facility. The Commission recently recertified the Facility as a qualifying cogeneration facility. See Washington Power Co., L.P., 70 FERC ¶ 62,168 (1995) (Cogeneration Recertification). In each case, the Commission certifications were issued pursuant to delegated authority. 18 C.F.R. 375.308(b)(4) (1994).

The Purchase Agreement further provides for certain "milestone" dates by which certain events in the development of the Facility were to be completed, failure to comply with which would effect a termination of the Purchase Agreement. Among the milestones is completion of construction financing for the Facility, the date for which was originally set at October 1, 1989. The conditions precedent for completion of financing include obtaining the requisite regulatory approvals, among which are the Pennsylvania Commission's acceptance of the Purchase Agreement and its approval for West Penn's passing through to its customers the rates payable to Washington Power.[12]

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Whether construction of the Facility actually has begun appears to be in dispute. Washington Power asserts in this proceeding that it has commenced construction. Washington Power Protest at 33 & n.11. Additionally, in its application for certification of the Facility as a small power production QF, Washington Power represented that construction began in July 1994. See 69 FERC at 64,296. West Penn, however, asserts that the Facility is "unbuilt" and argues that the Commission's failure to grant the relief sought by West Penn "may result in construction" of the Facility. West Penn Petition at 11. Several intervenors expressly allege that Washington Power has not yet commenced construction of the Facility. We need not and do not make any determination as to the accuracy of the competing allegations on this point.

10 The Purchase Agreement, which is Exhibit D to the West Penn Petition, was executed by North Branch Energy Partners, L.P., which was Washington Power's name at that time. For convenience, we will refer to the developer of the Facility as Washington Power throughout this order.

11 While West Penn avers that only the capacity rate is at issue in this proceeding, West Penn Petition at 4, it nonetheless elsewhere appears to request from the Commission a determination that no purchase obligation of any type exists between West Penn and the Facility. See id. at 38.

12 See Purchase Agreement §§ 5.3(f)-(i).

On January 5, 1988, West Penn submitted the signed Purchase Agreement to the Pennsylvania Commission for approval. The Pennsylvania Commission initially approved the Purchase Agreement as executed in an order dated July 8, 1988. The Pennsylvania Commission's first approval did not entail any modification of the Purchase Agreement, including the capacity charge and milestone dates to which West Penn and Washington Power originally agreed. Thereafter, a lengthy course of litigation ensued before the Pennsylvania Commission and the Pennsylvania courts, culminating in an unsuccessful petition for certiorari filed by West Penn with the United States Supreme Court. We will not here describe all of the subsequent decisions of the Pennsylvania Commission and the Pennsylvania courts. Instead, our description is limited to those aspects of the various orders that are pertinent to the issues raised in the West Penn Petition.[13]

C. West Penn Petition

In its petition, West Penn requests that the Commission address several issues concerning an electric utility's obligations to purchase QF power, particularly regarding the appropriate point or points at which to calculate the utility's avoided costs. Specifically, West Penn asks this Commission to declare that under federal law:

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13 While the parties disagree as to the effect and proper interpretation of the earlier decisions, the actual orders of the Pennsylvania Commission and the Pennsylvania courts are, of course, matters of record, with most of the court decisions having been published in official reporters. In any case, copies of nearly all of the orders involving the Facility also are contained in Exhibit F to the West Penn Petition. Exhibit F is the Appendix to West Penn's petition for certiorari to the United States Supreme Court, filed in Docket No. 94-7 on July 1, 1994. The most recent order of the Pennsylvania Commission, dated December 16, 1994, is Attachment A to the Washington Power Protest.

(1) An electric utility may not be required to purchase capacity from a QF when, as West Penn alleges is the case here, (a) the rates exceed the utility's current avoided costs, (b) the rates are based upon stale avoided cost data, (c) the utility no longer needs the capacity and (d) the QF is unbuilt;

(2) (a) A State regulatory authority may not modify material terms of a privately negotiated power purchase agreement between a utility and a QF; or (b) if the contract is so modified, the utility must be allowed to demonstrate that the contract's purchase price exceeds the utility's avoided costs as of the time of the modification;

(3) Avoided costs must be redetermined when a QF materially changes its project or seeks certification of a new project design; and

(4) West Penn has no current purchase obligation from Washington Power's QF facility.[14]

West Penn argues, first, that PURPA's setting as the maximum rate for QF power "the incremental cost to the electric utility of alternative electric energy"[15]--i.e., avoided costs-means that the purchase price never can exceed the utility's current avoided costs at any time during the term of the purchase agreement. West Penn initially suggests that

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14 See West Penn Petition at 1-2, 37-38.

15 16 U.S.C. § 824a-3(b) (1988).

the Commission's regulations under PURPA, by permitting rates to be based on avoided costs to be calculated as of the time the utility incurs a legally enforceable obligation to purchase a QF's power and by explicitly recognizing that such rates are permissible even if they differ from the utility's avoided costs at the time of actual delivery of the QF's power and capacity, create an ambiguity concerning whether a QF can "lock in" long-term rates for the entire life of a contract even if such rates turn out later to exceed the utility's actual avoided costs. West Penn asserts that if such provisions of the Commission's PURPA regulations in fact permit purchase rates that exceed avoided costs on a long-term basis, those regulations "are, and always have been, in clear violation of the express terms of PURPA § 210."[16]

West Penn then suggests, however, that the Commission never intended that its regulations be so interpreted. In support, West Penn asserts that while the regulations provide that avoided costs may be calculated "prior to the beginning of [a] specified term,"[17] the Commission never has suggested that the "specified term" of a purchase agreement between an electric utility and a QF might be several decades. West Penn infers that "[p]resumably, the Commission realized that avoided costs could vary significantly over time, and that long-term purchase rates premised on avoided costs should be subject to correction if circumstances changed materially."[18]

West Penn construes our recent orders in Southern California Edison and Connecticut Power as providing additional support for its argument that the Commission

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16 West Penn Petition at 22.

17 18 C.F.R. § 292.304(d)(2) (1994).

18 West Penn Petition at 23.

should abrogate West Penn's 1987 Purchase Agreement with Washington Power because the rates allegedly exceed West Penn's current avoided costs. West Penn quotes, for example, our statement in Southern California Edison that "[w]e believe it is inconsistent with our obligation under PURPA to ensure just and reasonable rates, and our goals to encourage development of competitive bulk power markets, to permit the use of PURPA to create new contracts that do not reflect market conditions for new bulk power supplies."[19] West Penn further notes the Commission's concerns, expressed in dicta in Southern California Edison, about the need for the capacity and the staleness of the data at issue in that case. West Penn adds that the Commission held in Connecticut Power that, contrary to suggestions in the preamble to our § 210 regulations, states have no authority under PURPA to authorize rates that exceed avoided costs. "Both opinions," West Penn concludes, "strongly suggest that the avoided cost cap must be strictly enforced."[20]

West Penn's second argument is that the Pennsylvania Commission had no authority to modify the Purchase Agreement, because it was a privately negotiated agreement between an electric utility and a QF and thus protected by our PURPA regulations from any modifications by the Pennsylvania Commission.[21] In support, West Penn quotes section 292.301(b) of this Commission's PURPA regulations:

> Nothing in this subpart:

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19 Id. at 24 (quoting 70 FERC at 61,676).

20 West Penn Petition at 25.

21 See id. at 26-29

(1) Limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.[22]

West Penn construes section 292.301(b) of our PURPA regulations as not only authorizing utilities and QFs to make their own contractual arrangements independent of our PURPA regulations but also as precluding State regulatory authorities from ordering modifications to utilities, contracts with QFs. West Penn argues in particular that the Pennsylvania Commission violated section 292.301(b) by changing certain milestone provisions, which West Penn claims it negotiated for its protection, while enforcing a purchase price based on allegedly stale data.

Alternatively, West Penn argues, if PURPA permits a State regulatory authority to modify a privately-negotiated utility/QF contract, the purchase price must be based upon the utility's avoided costs as of the time of the modification.[23] In support, West Penn opines that until the date of the modification, the QF has no legally enforceable obligation to deliver power.

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22 18 C.F.R. § 292.301(b) (1994). The "subpart" to which the above-quoted language refers is Subpart C of the Commission's PURPA regulations. Subpart C governs arrangements between electric utilities and QFs under section 210 of PURPA, including arrangements for utilities' purchases from QFs.

23 See West Penn Petition at 29-31.

Finally, West Penn claims that, because Washington Power obtained dual certification of the Facility as a qualifying small power production facility after its initial certification as a qualifying cogeneration facility, the Purchase Agreement is void and West Penn has no obligation to purchase capacity from the Facility.[24] West Penn argues that Washington Power's proposed small power production facility is substantially different from the proposed cogeneration facility that the parties contemplated when they signed the Purchase Agreement in 1987 and that it neither has agreed, nor has been ordered by the Pennsylvania Commission, to purchase capacity from Washington Power's proposed, allegedly redesigned, small power production facility. West Penn urges that if and when it is required to purchase capacity from Washington Power's small power production facility, the rates must be calculated as of the date that Washington Power incurs a legally enforceable obligation to deliver the capacity. In West Penn's view, that date as of which the purchase rate must be calculated could only be some future date upon which the Pennsylvania Commission orders West Penn to purchase power from the small power production facility certified by this Commission.

Notice of the West Penn Petition was published in the Federal Register,[25] with protests and motions to intervene originally due on or before April 3, 1995. By notice of the Commission issued on March 3, 1995, the due date for protests and interventions was extended to April 5, 1995.

D. Response of Washington Power

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24 See id. at 32-37. See also supra note 9 (citing Commission's QF certification orders for Facility).

25 60 Fed. Reg. 14,741 (1995).

Washington Power filed a motion to intervene on March 30, 1995, and followed, on April 3, 1995, with the Washington Power Protest, which contains its substantive arguments against the West Penn Petition. After summarizing what it regards as the salient aspects of the Purchase Agreement and the prior legal proceedings, Washington Power argues, first, that the West Penn Petition must be dismissed on the grounds of res judicata. Washington Power asserts that this case satisfies all of the requirements for application of the res judicata doctrine as adopted by the Commission in Greensboro Lumber Co. v. Rayle Electric Membership Corp., 40 FERC ¶ 61,283 (1987) (Greensboro). Specifically, Washington Power urges, the West Penn Petition involves the same cause of action, the same parties and the same issues that were raised or that could have been raised in the prior proceedings before the Pennsylvania Commission, the Pennsylvania courts and the United States Supreme Court. Washington Power contends that West Penn, having had its arguments consistently rejected in all of the prior litigation, should not be permitted to resurrect its arguments before the Commission, thereby "being offered yet another bite at the apple."[26]

Washington Power's second argument is that, even if res judicata did not bar the West Penn Petition, West Penn's claim that changed circumstances entitle it to avoid its obligations under the Purchase Agreement still provide no basis for the Commission to grant the requested relief. Washington Power's argument on this point is two-fold. First, Washington Power asserts that the Commission has no jurisdiction to invalidate the Power Agreement and its rates because under our regulations issued pursuant to section 210(e) of PURPA, QFs are exempt from utility-type regulation, including such regulation under both state law and the FPA. Thus, Washington Power concludes, once the State

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26 Washington Power Protest at 16.

regulatory authority has determined that the contract rates are consistent with the avoided cost cap, neither the State authority nor this Commission has authority to revisit those rates on the basis of allegedly changed circumstances.[27]

Washington Power further argues that the Commission already has addressed and rejected the claim that changed circumstances justify revising agreed-upon avoided cost rates. Washington Power, quoting extensively from the preamble to the Commission's regulations implementing section 210 of PURPA, urges that in enacting those regulations, the Commission expressly recognized that basing rates in long-term contracts on avoided cost estimates made at the time of contracting will result in some contracts that will have overestimated avoided costs and some that will have underestimated. Moreover, Washington Power asserts, the discussion in the preamble also demonstrates that the Commission considered and expressly rejected the changed circumstances argument now made by West Penn and concluded instead that QFs, having obtained the certainty of long-term rates, should not be deprived of the benefits of that certainty as a result of changed circumstances.

Washington Power next argues that to the extent that the West Penn Petition claims that sections 292.304(b)(5) and 292.304(d)(2)(ii) of the Commission's PURPA regulations violate section 210 of PURPA by permitting rates in excess of current avoided costs, such challenge to the regulations is untimely and jurisdictionally defective. Washington Power asserts that the regulations became final and nonappealable in 1980 and that West Penn cannot evade that bar by attempting to characterize its challenge as

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27 In support, Washington Power cites, among other cases, Freehold Cogeneration Association, L.P. v. Board of Regulatory Commissioners, 44 F.3d 1178 (3d Cir. 1995) (Freehold).

addressing the implementation of the regulations rather than the regulations themselves.

Fourth, Washington Power disputes that either Connecticut Power or Southern California Edison provides any support for West Penn's claims. Washington Power distinguishes Connecticut Power as involving a challenge under PURPA, not resolved by the courts in prior litigation, to a state law that required rates acknowledged to be above avoided costs. Here, Washington Power argues, the challenged rates were found by the Pennsylvania Commission to be below avoided cost at the time of a legally enforceable obligation, and that determination, as well as the revised milestone dates, was addressed and upheld by the courts.

Washington Power also argues that this case differs from Southern California Edison, because West Penn's claim, raised only after the Power Agreement was signed, that current avoided costs are lower because it no longer needs the Facility's capacity, has been fully litigated through the courts and is no longer pending. Washington Power adds that the Commission's dicta in Southern California Edison expressing concern with the staleness of the data used in that case to determine avoided costs does not support West Penn's position, because the data used to calculate the Purchase Agreement capacity rate were not stale as of the time the contract was signed.

Finally, Washington Power argues that the Facility's dual QF certification as both a qualifying small power production and a qualifying cogeneration facility is irrelevant to the issue of the avoided cost rates under the Purchase Agreement. Washington Power explains that it obtained additional certification as a qualifying small power production facility because the Facility intends to use a waste fuel as its primary energy source.

E. Response of Pennsylvania Commission

Having filed a notice of intervention and reservation of the right to protest on March 29, 1995, the Pennsylvania Commission filed its protest and motion to dismiss on April 3, 1995. In its protest and motion to dismiss, the Pennsylvania Commission details the prior litigation over the Purchase Agreement and asserts that the issues raised by the West Penn Petition have been fully adjudicated before the Pennsylvania Commission, whose resolution of those issues has been left undisturbed by both the Supreme Court of Pennsylvania and the United States Supreme Court. The Pennsylvania Commission contends, therefore, that the doctrine of res judicata (claim preclusion) bars West Penn from relitigating the issues before this Commission.

Characterizing the West Penn Petition as in essence asserting that an alleged change in capacity needs since the time that a legally enforceable obligation was incurred requires revisiting the Purchase Agreement, the Pennsylvania Commission observes that this argument has been raised by West Penn in prior proceedings and has been repeatedly rejected. The Pennsylvania Commission asserts that West Penn now seeks this Commission's assistance in the rescission of prior-adjudicated Pennsylvania Commission orders that have been upheld by all appellate courts. The Pennsylvania Commission further points out that West Penn at the same time also not only now has asked the Pennsylvania Commission to rescind its own orders, notwithstanding the refusal of the United States Supreme Court to overturn them, but continues to challenge before the Pennsylvania courts the state commission's refusal to permit West Penn to relitigate its previously-rejected claims.

The Pennsylvania Commission also argues that under PURPA and our regulations, the issues raised by West Penn

are appropriately determined not by this Commission but at the state level. The Pennsylvania Commission states that in the amici brief filed in September 1994 in response to West Penn's certiorari petition to the United States Supreme Court in a companion case to that involving the Facility, this Commission agreed that the Pennsylvania Commission's actions with respect to the Power Agreement were not inconsistent with PURPA and, in particular, that it was reasonable for the Pennsylvania Commission to calculate the capacity rate as of the date of contract execution. The Pennsylvania Commission asserts that those determinations, now being challenged by West Penn yet again in this proceeding, remain reasonable and within the authority that PURPA delegates to the States. The Pennsylvania Commission urges this Commission to reject West Penn's attempt to have the Commission micromanage the details of PURPA contract administration, requiring the Commission to delve into fact-based issues as to such matters as avoided costs and capacity needs for specific facilities, when our own regulations expressly delegate such matters to the States.

F. Other Responses

On March 29, 1995, Armco Advanced Materials Company, a Business Unit of Armco, Inc. (Armco), a retail customer of West Penn, filed a motion to intervene in support of the West Penn Petition. Armco argues that if West Penn is required to purchase capacity from the Facility--on which, according to Armco, no construction has begun[28]--rates to retail customers would increase substantially and result in substantial economic harm to Armco, which currently consumes approximately five percent of all energy sold by West Penn at retail in Pennsylvania. Armco agrees with West Penn that the

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28 But see supra note 9 (describing parties', disagreement as to whether construction has begun).

Purchase Agreement rates were based on a now outdated capacity expansion forecast from 1986/1987 and that West Penn now does not need the Facility's capacity. Armco further argues that the Purchase Agreement will be a stranded cost that will deter any state or federal effort to open up to competition the West Penn system and thus is not in the public interest.

On March 31, 1995, the West Penn Power Industrial Intervenors (Industrials) filed a motion to intervene in support of the West Penn Petition. Industrials identifies itself as an ad hoc association of energy-intensive industrial customers of West Penn.[29] Industrials agrees with West Penn's claims that the Purchase Agreement's capacity charge of 5.71@/kWh exceeds West Penn's current avoided costs and will cause West Penn's ratepayers to incur excess costs of $962 million over the life of the contract. Industrials further agrees with West Penn that such rate increases would damage the competitive positions of West Penn and its industrial customers.

On April 3, 1995, Allegheny Ludlum Corporation (Allegheny Ludlum) filed a motion to intervene in support of the West Penn Petition. Allegheny Ludlum states that it is a manufacturer of stainless steel and other specialty steel products and is one of West Penn's two largest retail customers. Like Armco and Industrials, Allegheny Ludlum agrees with West Penn that the rates under the Purchase Agreement exceed current avoided costs and that West Penn currently has no need for additional capacity. Allegheny Ludlum contends that the Facility has neither been built nor

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29 Industrials states that its membership for purposes of this proceeding currently consists of Anchor Glass Container Corporation, Corning Incorporated, Ervin Industries, Latrobe Steel Company, Lukens Steel Company, MG Industries, National Roll Company, Owens-Illinois, Inc. and Washington Steel Corporation.

financed and that it is unfair to West Penn's ratepayers to force them to bear the costs of an unneeded power plant so that Washington Power and its investors can reap what Allegheny Ludlum characterizes as windfall profits. Allegheny Ludlum further suggests that forcing the West Penn ratepayers to incur the costs of the Facility will "severely diminish the ability of industrial companies to compete in the marketplace, and . . . effectively threaten the jobs of thousands of residents in southwestern Pennsylvania."[30]

On April 3, 1995, the Cogeneration Association of California (Cogeneration Association) filed a motion to intervene and protest in opposition to the West Penn Petition. Cogeneration Association states that it is an ad hoc association representing the interests of its member companies in several cogeneration companies.[31] It explains that such cogeneration companies are primarily engaged in electrical generation and the sale of steam for enhanced oil recovery operations in California and that they sell electricity pursuant-to long-term contracts. Cogeneration Association argues that granting the relief sought by West Penn would undermine both the sanctity of contracts, relied upon by QFs to obtain financing, and years of Commission precedent, upon which QFs also have relied, concerning the validity and enforceability of QF contracts that have been approved by State regulatory authorities. Cogeneration Association argues that neither PURPA nor the Commission's regulations permit the undoing of valid and binding contracts because of changing market conditions.

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30 Allegheny Ludlum Intervention at 7.

31 Cogeneration Association states that the constituent cogeneration companies include Sycamore, Kern River, Midway Sunset, Mid-Set, Coalinga, Sargent Canyon and Salinas River Cogeneration Companies.

Also on April 3, 1995, National Independent Energy Producers (NIEP) filed a motion to intervene, protest and answer in opposition to the West Penn Petition. NIEP states that it is an association of a variety of publicly-traded and privately-held corporations that develop and operate cogeneration and other wholesale generation facilities that use a broad spectrum of fossil-fueled and renewable technologies, as well as power marketers. NIEP argues that the West Penn Petition presents the Commission with one primary question that is similar to the main issue in NYSEG: can and should the Commission terminate or modify the Purchase Agreement, after it has been voluntarily executed by West Penn and approved by the Pennsylvania Commission, simply because the-contract differs from West Penn's current estimates of avoided costs and its current forecasts of demand on its system? NIEP urges the Commission to reject West Penn's proposal, because accepting it would be inconsistent with PURPA and the Commission's regulations, would destroy the certainty of income stream upon which QF financing is based and would chill development of new generation projects and thereby destroy competition in the wholesale generation market.

NIEP argues, first, that the Purchase Agreement is consistent with PURPA and the Commission's implementing regulations and that PURPA prevents modifications of the Purchase Agreement after it has received approval by the Pennsylvania Commission. In enacting PURPA, NIEP asserts, Congress recognized the difficulty that QFs would have obtaining financing and gave the Commission the authority and responsibility to implement regulations that would further the development of QFs. The Commission, in turn, recognized that it would be virtually impossible to finance QFs without assurances of a steady stream of revenue to cover their fixed costs and accordingly provided in its regulations that QFs could choose to sell power to an electric utility at a pre-determined fixed rate that represents

an estimation of the utility's avoided cost. Moreover, the Commission expressly acknowledged that the rates under the permissible fixed-rate QF contracts may exceed current market prices. NIEP argues that West Penn's interpretation of PURPA and the Commission's regulations essentially would eliminate the fixed-rate option now provided to QFs in the regulations.

NIEP's argument that, PURPA precludes attempts to modify power purchase contracts after the State regulatory authority has approved them is essentially the same as Washington Power's argument on this point.[32] NIEP also cites in support a recent temporary restraining order issued by the United States District Court for the Western District of New York in Kamine/Besicorip v. Rochester Gas & Electric, No. 6:95-cv-06045 (March 20, 1995) (Kamine), in which the court prevented the utility from suspending payment under a power purchase contract with a QF where the utility claimed that the rates exceeded the utility's avoided cost. NIEP states that the Kamine court followed Freehold in determining that a utility was precluded from seeking to modify the rates in its power purchase agreement. NIEP additionally argues that West Penn's request to have the Commission evaluate the rates under the Purchase Agreement (as well as West Penn's present need for the Facility's output) is precisely the kind of regulatory review that is precluded by QFs, exemption from regulation under the FPA that section 210(e) of PURPA provides. NIEP concludes that the only jurisdiction that the Commission has over QF contracts is to ensure that states abide by the Commission's regulations implementing PURPA.

NIEP's second argument is that granting West Penn's requested relief would be bad public policy and would harm

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32 See supra text accompanying note 27.

competition in the generation market. NIEP contends that adopting West Penn's position not only would vitiate QFs' ability to obtain financing through the use of fixed-rate contracts and thus inhibit the construction of new generating facilities but also would undermine the pervasive use of long-term contracts throughout the industry. The result, NIEP argues, would be to reduce competition in the generation markets and increase the cost of generation to consumers.

Fulton Cogeneration Associates (Fulton) filed a motion to intervene on April 3, 1995. Fulton states that it is a New York limited partnership formed for the purpose of constructing a cogeneration facility in Fulton, New York. Fulton explains that it is a QF and that any determination in this proceeding with respect to the validity of QF contracts could affect it. Fulton takes no position on the West Penn Petition and raises no issues.

ANR Pipeline Company (ANR) filed a motion to intervene on April 3, 1995. It states that it is a natural gas transmission company that, pursuant to long-term firm contracts, transports natural gas to a substantial number of cogeneration QFs in New York and New Jersey. ANR asserts that a determination in this proceeding concerning purchase obligations under QFs' contracts with utilities could affect its long-term firm natural gas transportation contracts. ANR takes no position on the West Penn Petition and raises no issues.

On April 4, 1995, the Pennsylvania Office of Consumer Advocate (Consumer Advocate) filed a motion to intervene in support of the West Penn Petition. Consumer Advocate explains that it is a state agency empowered by statute to represent the interests of consumers of utility services in the Commonwealth of Pennsylvania before the Pennsylvania Commission, similar federal regulatory agencies and state and federal courts. Consumer Advocate suggests

that the West Penn Petition raises an unresolved issue regarding the implementation of PURPA's requirements, particularly in view of the Energy Policy Act of 1992 and other developments that have increased competition in the electric utility industry. Specifically, Consumer Advocate argues, the West Penn Petition presents the issue whether PURPA requires a utility to pay a rate for QF power that exceeds current avoided cost when the purchase rates are based on stale data, the utility no longer needs the capacity and the QF remains unbuilt. Consumer Advocate contends that from the perspective of Pennsylvania's consumers, requiring West Penn to purchase the Facility's capacity and energy at rates in excess of avoided cost, now and in the foreseeable future, cannot result in rates that are just and reasonable.

Consumer Advocate argues that while PURPA intended to encourage the development of QFs, it made clear that a utility's ratepayers should not subsidize the utility's mandated purchase of QF power. In this case, Consumer Advocate avers, requiring West Penn to proceed with the Purchase Agreement would violate that balance. Consumer Advocate argues that because the Facility is not built, West Penn's requested relief is not precluded by Southern California Edison or Freehold. Consumer Advocate asserts that those decisions left unresolved the issue presented in this case, which it characterizes as whether PURPA requires West Penn to go forward with a contract that is now known to be for unneeded capacity at rates in excess of current avoided costs. Consumer Advocate acknowledges that it can be argued that West Penn must be required to honor the Purchase Agreement because the delays in the Washington Power project result from West Penn's own actions but nonetheless contends that that would be unfair to West Penn's ratepayers, who will be asked to pay the costs of the contract. Finally, Consumer Advocate argues that the project, if completed, potentially would be stranded

investment and thus would hinder, not foster, the development of competitive generation markets.

On April 5, 1995, PECO Energy Company (PECO) filed a motion to intervene. PECO states that it is an operating utility that provides electric service in southeastern Pennsylvania and northern Maryland. It represents that as an electric utility subject to both PURPA and the Pennsylvania Commission's implementing regulations, which are at issue here, it may be directly affected by the outcome of this proceeding. PECO takes no position on the West Penn Petition and raises no issues.

The Mid-Atlantic Independent Power Producers (Mid-Atlantic Independents) also filed a motion to intervene on April 5, 1995. Mid-Atlantic Independents states that it is a trade association that represents companies and individuals who have interests in the competitive power market in Maryland, Pennsylvania, New Jersey, Delaware, Virginia and the District of Columbia, including members involved in the development of QFs. Because its members are consumers of West Penn's utility services, are competitors of West Penn in the wholesale energy market and are parties to and beneficiaries of the types of QF contracts under PURPA that the West Penn Petition challenges, Mid-Atlantic Independents states that its interest and its members, interests are likely to be directly affected by the outcome of this proceeding. Mid-Atlantic Independents takes no position on the West Penn Petition and raises no issues.

Finally, in addition to the intervening West Penn industrial retail customers already identified, a substantial number of West Penn retail customers, primarily individual ratepayers, have written to the Commission expressing their opposition to Washington Power's project. Most of the letters reached the Commission after the April 5 deadline for filing protests and motions to intervene. We note, however,

that none of the letters constitutes a formal motion to intervene or (as they all support West Penn's position) a protest. The letters are for the most part substantively identical. One letter, filed April 18, 1995, attaches a sheet that sets forth, in abbreviated and highly partisan terms, the "facts" regarding the excess cost of and lack of need for the Facility (as well as the Milesburg and Shannopin QFs). That same version of the facts is reflected both in West Penn's pleadings in this case and in most of the letters from West Penn's retail customers. Thus most of the letters object to requiring West Penn to purchase the Facility's power on the grounds that it is unneeded and overly expensive and that forcing West Penn to buy the power is likely to lead to substantial rate increases for West Penn customers and the risk of job losses in the region because of increased industrial and commercial electric rates.

G. West Penn Answer

On April 17, 1995, West Penn filed an answer (West Penn Answer) to the motions to dismiss of Washington Power and the Pennsylvania Commission.[33] The West Penn Answer also supplements the West Penn Petition by arguing that NYSEG, which was issued after the filing of West Penn's original petition, does not bar the relief requested by West Penn.

In its answer to the motions to dismiss, West Penn argues that, for five specified reasons, its petition is not barred by the doctrine of res judicata. First, West Penn asserts that the doctrine is not applicable in utility rate proceedings, because such proceedings are inherently subject to changes in circumstances. West Penn claims that the

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33 West Penn correctly notes that while our regulations do not permit answers to protests, they do permit answers to motions to dismiss. See 18 C.F.R. §§ 385.213(a)(2)-(3) (1994).

proceedings in this case "ultimately are indistinguishable from a rate proceeding."[34] Second, West Penn claims that the Commission has not applied res judicata where the prior adjudication is based on stale data. For this proposition, West Penn relies on an administrative law judge's opinion addressing decommissioning expenses for a nuclear plant, which West Penn claims are. similar to QF rates.[35] Third, West Penn claims that under the Commission's interpretation of the doctrine of primary jurisdiction, res judicata does not bar West Penn's request for relief from a state court judgment that erroneously interpreted the Commission's regulations. Fourth, West Penn alleges that it has not had a full and fair opportunity to litigate before the Pennsylvania Commission and courts the same cause of action raised by its petition to this Commission. West Penn asserts that its first requested declaration--that a utility cannot be required to purchase power from a QF when the rates exceed the utility's current avoided costs and are based upon eight-year-old data--obviously was never resolved by the Pennsylvania courts because it depends on facts currently available. West Penn adds that whether a QF's recertification and alleged substantial redesign triggers a new avoided cost determination also was not decided by the Pennsylvania courts. Finally, as to res judicata, West Penn argues that the doctrine, even if otherwise applicable to this case, cannot bar the Commission from issuing adjudicative rules--i.e., an interpretation of its PURPA regulations--in its legislative capacity.

West Penn also responds to Washington Power's argument that the Commission lacks jurisdiction to modify the Purchase Agreement. West Penn asserts that neither Freehold nor the Commission's regulations preclude it from

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34 West Penn Answer at 9.

35 West Penn cites the administrative law judge's initial decision in Boston Edison Co., 59 FERC ¶ 63,028 at 65,239 (1992).

interpreting its regulations and finding that the Pennsylvania Commission's modifications of the Purchase Agreement violated federal law. West Penn asserts that it is not asking this Commission to "'second-guess state regulatory authorities, actual determinations of avoided costs."'[36] Rather, West Penn insists, its challenge to the Pennsylvania Commission's actions is consistent with the Commission's statement in Southern California Edison that its role is limited to ensuring that the process. used by the state commission to calculate the per unit charge accords with PURPA and this Commission's regulations.

Third, West Penn argues that the preamble to our PURPA regulations did not in fact consider and reject the claim of changed circumstances now asserted by West Penn. West Penn urges that even if Washington Power has correctly interpreted the preamble discussion, this Commission is not bound by the preamble. West Penn adds that, because avoided costs allegedly have declined since the regulations were enacted, the Commission should reject the preamble discussion to the extent that it suggests that changed circumstances will not require reconsideration of QF rates.

West Penn also offers further arguments as to why our decisions in Connecticut Power and Southern California Edison allegedly support its requested relief and as to why Washington Power's dual certification requires recalculation of the Purchase Agreement rates. Finally, West Penn attempts to explain why our recent decision in NYSEG does not preclude granting West Penn its requested relief.[37]

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36 West Penn Answer at 25 (quoting Southern California Edison, 70 FERC at 61,677). We made clear in that case, of course, that we will not engage in such second guessing.

37 West Penn's arguments on these points, to the extent that they are of any substance and relevance, are addressed in our discussion below on

## II. Discussion

### A. Procedural Matters

Under Rule 214 of the Commission's Rules of Practice and Procedure,[38] the notice of intervention of the Pennsylvania Commission and the timely, unopposed motions to intervene of Washington Power, Armco, Industrials, Allegheny Ludlum, Cogeneration Association, NIEP, Fulton, ANR, Consumer Advocate, PECO and Mid-Atlantic Independents serve to make them parties to this proceeding.

### B. West Penn's Requests for Relief

The gravamen of the West Penn Petition is an allegation that the Pennsylvania Commission, in violation of PURPA and this Commission's implementing regulations, modified the Purchase Agreement by calculating the rates based on avoided costs estimated as of the date of the contract's execution and by extending certain milestone dates to take account of litigation delays. Additionally, West Penn asks us, in essence, to declare that PURPA and our regulations require that established rates in long-term QF contracts be recalculated if changed circumstances result in avoided cost projections that differ from earlier avoided cost projections upon which the rates originally were based.

We will deny West Penn's petition. West Penn's complaints about the specific actions taken by the Pennsylvania Commission regarding the Purchase Agreement

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the merits of the West Penn Petition, and we will not,repeat the arguments here.

38 18 C.F.R. § 385.214 (1994).

already have been fully litigated in another forum. We will not entertain an attempt to relitigate before this Commission matters that have been settled by the Pennsylvania courts, whose determinations the United States Supreme Court also declined to disturb. The Pennsylvania Commission's modifications to the Purchase Agreement involve fact-based determinations and PURPA enforcement issues that we consistently have regarded as the province of the States.[39] Moreover, West Penn's attack on our PURPA regulations permitting rates for QF contracts to be calculated as of the time a legal obligation for the sale of power is incurred raises essentially the same issue that we addressed and rejected in NYSEG.[40]

West Penn argues that it really is challenging the "process" by which the Pennsylvania Commission determines avoided costs in general and is not asking us to "second-guess" the Pennsylvania Commission's actual determination of avoided cost for the Facility.[41] By this assertion, West Penn seeks to evade our warnings in Southern California Edison and NYSEG that we would not engage in such second-guessing.[42] West Penn's effort is unsuccessful. Our regulations, expressly permit rates in longterm QF contracts to be based on avoided costs as of the time a legally enforceable obligation is incurred. It is up to the States, not this Commission, to determine the specific

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39 See, e.g., NYSEG, slip op. at 22.

40 West Penn's final argument, regarding the supposed effect of recertification of a QF, is, as we discuss below, essentially a variation on its argument that changed circumstances require recalculation of avoided costs and is, we find, without merit.

41 West Penn Answer at 25-26.

42 See Southern California Edison, 70 FERC at 61,677; NYSEG, slip op. at 22.

parameters of individual QF power purchase agreements,[43] including the date at which a legally enforceable obligation is incurred under State law. Similarly, whether the particular facts applicable to an individual QF necessitate modifications of other terms and conditions of the QF's contract with the purchasing utility is a matter for the States to determine. This Commission does not intend to adjudicate the specific provisions of individual QF contracts.[44]

One other of West Penn's arguments that merits comment is its claim that its petition is not precluded by our determination, as explained in Connecticut Power and Southern California Edison and confirmed in NYSEG, that we will not accept challenges to State-approved avoided-cost rates unless the rates were challenged prior to the execution of the contract and the challenge is pending. We agree that in this case, West Penn had no reason to challenge the Purchase Agreement prior to the date of execution.[45] We do not agree, however, that West Penn's challenge to the Purchase Agreement as modified by the Pennsylvania Commission is ongoing or pending in the sense that we contemplated in our prior decisions. The only reason that West Penn now can contend that the matter is pending is that it refused to accept the judgments of the Pennsylvania courts and the

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43 See NYSEG, slip op. at 22.

44 Moreover, as we pointed out in our amici brief in the companion certiorari proceedings to those involving Washington Power, we do not find Pennsylvania's determinations on these issues, the resolution of which are State responsibilities, inconsistent with or in violation of PURPA or our regulations. See Pennsylvania Commission Protest Appendix A at 17-20. None of West Penn's arguments in this proceeding persuades us to reverse our earlier view.

45 As all parties agree, the rates as originally set were negotiated by West Penn and Washington Power and were not modified by the Pennsylvania Commission in its initial acceptance of the contract.

Pennsylvania Commission, as left standing by the United States Supreme Court. Instead of accepting the court decisions, West Penn has sought to reopen the issues before this Commission as well as before the Pennsylvania Commission. While West Penn has attempted to fit its petition into certain isolated language in our recent orders, it ignores the intent of those decisions.

In addition to challenging specific Pennsylvania Commission actions affecting the Purchase Agreement, a claim that we have rejected, West Penn also asks this Commission to declare that PURPA and our regulations do not require, and indeed preclude, a utility's purchase of power from a QF when the rates exceed the utility's current avoided costs, the rates are based upon stale avoided-cost data, the utility no longer needs the capacity and the QF is not yet built. In essence, West Penn is arguing that changed circumstances mandate recalculation of rates based on avoided costs as of the time of the new circumstances. Thus West Penn directly challenges our long-standing rule, as set forth in section 292.304 of our PURPA regulations, that rates for a longterm QF contract based on avoided costs calculated as of the time the legal obligation to sell power was incurred continue to comply with statutory and regulatory requirements--including the requirement that QF rates be just and reasonable--even if the rates differ from avoided costs at the time the power is delivered.

West Penn raises essentially the same issue as was before the Commission in NYSEG. As we confirmed in that case, the provisions of section 292.304 allowing long-term fixed rate contracts for QFs--"lock-ins," in West Penn's parlance--mean what they say. As we further explained in NYSEG, in promulgating the regulations, we expressly considered and rejected the argument now made by West Penn that changed circumstances would require resetting of established rates to match the latest avoided cost

determinations. In NYSEG we examined in detail the legal and policy reasons why we would not amend or reinterpret our regulations in response to allegations that current avoided costs have fallen.[46] We will not repeat that discussion here except to confirm our continued adherence to the principles enunciated in NYSEG. While we do not believe that our discussion in NYSEG requires amplification, we will address certain of West Penn's additional arguments in which it attempts to distinguish its petition from issues that we resolved in NYSEG.[47]

First, West Penn claims that a critical factual distinction is that the Facility in this case is neither financed nor built. West Penn argues, therefore, that granting it relief from the Purchase Agreement will not undermine QF financing in general, because "the critical issue from a lender's point of view is stability after the financing is actually provided."[48] West Penn's argument on this point strikes us as somewhat disingenuous. Under West Penn's theory, the purchasing utility would be free to challenge the rates at any time before financing arrangements are completed, so that QF developers could be forced to pursue a "moving target" in attempting to arrange financing. Allowing utility challenges to rates at any point between the time that a legally enforceable obligation is incurred and the completion of financing could involve repeated delays. In any event, our

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46 See NYSEG, slip op. at 20-26.

47 We already have considered and rejected West Penn's arguments that NYSEG and our earlier decisions do not preclude its petition because (a) its challenge to the Purchase Agreement is ongoing, and (b) it is challenging only the "process" of the Pennsylvania Commission. See supra text accompanying notes 41-45.

48 West Penn Answer at 39.

regulations specifically authorize QF rates to be established as of the time a legally enforceable obligation is incurred.

Second, West Penn asserts that it is entitled to relief under Connecticut Power, quoting in support our description of that case in NYSEG. We stated in the latter case that in Connecticut Power, "we found that the rates for purchases from the QF in that case, as a legal matter, may have exceeded avoided costs at the time the rates were imposed, a situation we determined would be in violation of Section 210(b) of PURPA."[49] West Penn argues that it is entitled to relief on the same grounds, because the modified rates under the Purchase Agreement were imposed not in 1987 when the contract was signed but either in 1989 (when the Pennsylvania Commission established the date at which a legally enforceable obligation arose as the date of execution rather than during the negotiation period) or more likely 1992 (when the Pennsylvania Commission modified the rates to reflect avoided costs estimates as of the date of execution). West Penn alleges that the rates exceeded then current avoided costs estimates in both 1989 and 1992.

West Penn has misunderstood our decision in Connecticut Power. That case involved a challenge to a state statute that required QF rates to be set at rates that exceeded avoided costs regardless of when a legally enforceable obligation was incurred. In this case, the rates were set not by statute but were based on a determination, specific to the Purchase Agreement, as to the date at which the legally enforceable obligation was incurred. The fact that the determination as to the specific proper date in this case was made after the date itself is immaterial. For purposes of our regulations, the critical date is the date on which a legally enforceable obligation is incurred, and choosing that date for a

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49 NYSEG, slip op. at 23 (emphasis omitted).

specific QF is the responsibility of the States, not of this Commission.

West Penn's final argument, relating to the dual certification of the Facility as both a cogeneration and small power production QF, borders on the frivolous. The scope of a QF certification proceeding is quite narrow -- it is limited to a determination whether, on the facts presented in the certification application, the facility at issue will comply with the Commission's ownership and technical requirements for QFs. A QF certification proceeding does not address any issues that are unrelated to the limited definitional criteria for QF status.[50] Thus, the Commission's certifications of the Facility did not purport to address the rates and terms upon which West Penn would satisfy its obligation to purchase the Facility's capacity and energy or the time at which that obligation was incurred.

A QF certification or recertification is an entirely separate matter from when, for purposes of calculating avoided costs in accordance with sections 292.304(b)(5) and 292.304(d)(2)(ii) of our regulations, a "legally enforceable obligation" is incurred. The fact that dual certification is obtained for a single facility means only that the facility satisfies the requirements for both a qualifying cogeneration and a qualifying small power production facility. Moreover, recertification reflects the fact that, because QF certifications are issued based on the facts presented in the application at issue, recertification may be appropriate if any of the facts

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50 Midland Cogeneration Venture Limited Partnership, 56 FERC ¶ 61,361 at 62,393 (1991), aff'd mem. sub nom. Michigan Municipal Cooperative Group v. FERC, 990 F.2d 1377 (D.C. Cir. 1993) (per curiam), cert. denied, 114 S. Ct. 546 (1993) (Midland). Accord, e.g., Citizens for Clean Air and Reclaiming our Environment v. Newbay Corp., 56 FERC ¶ 61,428 at 62,523-33 (1991) (Newbay).

change.[51] In no sense does a QF certification or recertification ratify or impose modifications on any power sales contract to which the QF is party.

West Penn's invocation of the legislative history of the Solar, Wind, Waste, and Geothermal Power Production Incentives Act of 1990 is equally unavailing.[52] West Penn correctly points out that that legislation, which by increasing the permissible size limits under certain circumstances for small power production facilities under PURPA enabled Washington Power to obtain additional certification as a qualifying small power production facility, expressly did not intend to have the effect of requiring the purchase of additional capacity or energy under existing contracts. No such effect, however, resulted in this case. The obligations of West Penn to purchase capacity and energy from the Facility were established by the Purchase Agreement, which continued to govern those obligations after Washington Power's additional certification. Moreover, we note that West Penn incorrectly alleges that after the passage of that legislation, Washington Power converted from a cogeneration facility to a small power production facility.[53] That simply is not true. As our certification orders indicate, the Facility's certification as a qualifying small power production facility was in addition to, not in replacement of, its certification as a qualifying cogeneration facility.[54]

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51 See, e.g., Newbay, 56 FERC at 62,532-33; Midland, 56 FERC at 62,393.

52 See id. at 35-36.

53 Id. at 35.

54 See Cogeneration Recertification, 70 FERC at 64,386 n.1; Small Power Production Certification, 69 FERC 64,296 n.1. We note that West Penn did not intervene in or protest any of Washington Power's QF certification proceedings. See Cogeneration Recertification, 70

As noted above, the Pennsylvania Commission, and the courts, have determined that a valid, legally binding contract exists. Our decision not to disturb the contract has not turned on the factual issue of whether the contract rate required by the Pennsylvania Commission will in fact exceed West Penn's avoided cost over the term of the contract. However, if West Penn believes that this is the case, it should make every attempt to buy out (or buy down) the contract. We would encourage the parties to the contract to consider settling their differences particularly if the facility has not been constructed. Moreover, if this is the case, we believe that both the Commission and the Pennsylvania Commission should encourage such an effort.

We do not believe that there is any significant difference between this situation and that faced by utilities when they find that previously negotiated fuel contracts are no longer competitive due to changes in fuel markets. In the latter situation, we have encouraged utilities to buy out (or buy down) higher-priced fuel contracts in order to substitute lower-priced fuel currently available and we have allowed the recovery of prudently-incurred buy-out/buy-down costs. See Kentucky Utilities Company, 45 FERC ¶ 61,409 (1988).

The Commission is aware today, as it was in 1980 when it adopted its PURPA regulations, that some QF contracts may result in rates above avoided cost over the

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FERC at 64,386; Small Power Production Certification, 69 FERC at 64,296; Cogeneration Certification, 42 FERC at 63,443.

We note that West Penn claims that Washington Power's proposed small power production facility is "substantially different from the proposed cogeneration facility that formed the basis of the Purchase Agreement. West Penn Petition at 33. West Penn similarly alleges that Washington Power made a "substantial redesign of its proposed QF." West Penn Answer at 19. West Penn fails to specify any differences, however, and our QF certification orders reflect no such differences.

term of the agreement, just as some may result in rates below avoided cost. However, as we explained in Connecticut Power, NYSEG and in this order, we do not believe the remedy is to invalidate such contracts, except in narrow circumstances.[55] Rather, we believe the appropriate action is to buy out or buy down such contracts. To facilitate such action, we clarify that if utilities are prudent in buying out or buying down existing power purchase agreements, whether or not with QFs, this Commission will permit the recovery in wholesale rates of a pro rata share of the buy-out or buy-down costs.

The Commission orders:

The relief requested in the West Penn Petition is hereby denied as discussed in the body of this order.

By the Commission.

(SEAL)

Linwood A. Watson, Jr.,
Acting Secretary.

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55 See Connecticut Power, 70 FERC at 61,029-30; NYSEG, slip op. at 23-24.

No. 94-1995

(3)

Supreme Court, U.S.
FILED
AUG 15 1995
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1994

THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE,

*Petitioner*,

—v.—

FREEHOLD COGENERATION ASSOCIATES, L.P., *et al.*,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

## PETITIONER'S REPLY

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August 15, 1995

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This reply addresses the new issues raised in Respondent's Opposition Brief.

**I. Respondent's Contention, that "Other High Appellate" Court Decisions Are Consistent with the Decision of the Third Circuit, Is Incorrect.** (Opposition of Freehold Cogeneration Associates, L.P. ("Opp.") at 15).

Respondent Freehold Cogeneration Associates, L.P. ("Freehold") offered two decisions to support its contention: (1) *Indep. Energy Producers Ass'n v. Cal. Pub. Utils. Comm'n*, 36 F.3d 848 (9th Cir. 1984) ("IEPA") and (2) *Smith Cogeneration Management, Inc. v. Corp. Comm.*, 863 P.2d 1227 (Okla. 1993) ("Smith"). Neither of these decisions hold that Section 210(e) of the Public Utility Regulatory Policies Act of 1978 ("PURPA") forbids state regulators from implementing the PURPA/FERC prohibition against purchase prices exceeding the relevant PURPA/FERC purchase price ceiling. Rather, they stand for these principles: **(1) Any purported action by a state regulatory commission to require a purchase price at a level other than the relevant PURPA/FERC purchase price is preempted under the Supremacy Clause of the United States Constitution and (2) a contractual long-run fixed purchase price is not entitled to protection for the term of the contract *unless* the original contract price is at the relevant PURPA/FERC price in conformity with FERC rule 18 C.F.R. § 292.304(d)(2).**

A. The *IEPA* Case. The California Public Utility Commission ("CPUC') instituted a program that authorized utilities to apply operating and efficiency standards to qualifying facilities ("QFs") and, on determining that a QF did not comply, to substitute an "alternative" avoided cost rate for the avoided cost rate specified in a standard offer contract. The "alternative" avoided cost rate was calculated at 80% of the short-term "economy" published avoided cost rate. (36 F.3d at 858). The appellant had challenged the regulations on the ground that the program was preempted by PURPA and the Federal

Energy Regulatory Commission ("FERC") regulations. (at 853). The court upheld the challenge after a traditional Supremacy Clause analysis based upon the inconsistency of the state's program with PURPA. (The decision did not rest upon PURPA § 210(e), the basis of Freehold's action, which forbids "utility-type" regulation). (at 858).

Freehold omitted the following sentence from the otherwise complete paragraph that it quoted in its Opposition (at 15 and 16): "Federal regulations provide that QFs are entitled to deliver energy to utilities at an avoided cost rate calculated at the time the contract is signed." (Cit. Omitted). The paragraph of the decision preceding the paragraph quoted by Respondent is important to the meaning of the quoted paragraph. It says that the requirement to pay *full* avoided costs in 18 C.F.R. §292.304(d) *properly balanced* Congress' desire to promote cogeneration while not burdening ratepayers by requiring them to subsidize QFs. (at 858). The complete quoted paragraph in proper context of the original decision says that the Supremacy Clause of the United States Constitution prohibits a state regulatory commission from requiring a purchase price different from the relevant PURPA/FERC avoided cost of the utility. In particular, an excessive price would vitiate this balance and transgress Congress' concern about ratepayers' subsidizing QFs.

B. The *Smith Case*. Smith Cogeneration Management proposed to build a cogeneration plant and sought (1) to have the state regulatory commission fix the estimated avoided cost before the execution of a contract which obligated the QF to deliver power and (2) to waive the commission rule which mandated a contract provision allowing the commission to change the agreement during its term. (863 P.2d at 1230, 1237). The court applied, as in the *IEPA* case, traditional preemption doctrine (at 1239), not PURPA Section 210(e), and held (1) that the state's requirement to include the contract provision allowing the state to change rates was preempted because the provision was in conflict with PURPA and the

FERC regulations which grant QFs the right to have a long-term purchase contract at a price based on the avoided cost of the utility at the time the obligation to deliver is incurred (at 1240), (2) that Smith attempted to have avoided cost established for a 15-year contract before becoming legally obligated and (3) that, therefore, Smith was not entitled to have avoided cost fixed as a contractual purchase price for the life of the proposed agreement until Smith presented a contract legally obligating itself to deliver power at the avoided cost of the utility at the time the obligation was incurred. (at 1241).

Thus, the *IEPA* and *Smith* cases say that a state is preempted from approving a purchase price inconsistent with the PURPA/FERC ceiling and a contractual purchase price is not protected over the term of the contract from realignment in accordance with the PURPA/FERC rules unless that price was set originally at the proper PURPA/FERC prescribed level. Under these principles, Freehold is not entitled to have the price in the agreement protected because the price is higher than the relevant PURPA/FERC avoided cost of the utility at the time the agreement was presented for approval. The creation of a legal obligation was conditioned (1), by the regulations of the New Jersey Board of Public Utilities ("Board"), on the review and approval of the contract by the Board and (2), by the explicit agreement of the parties, on approval by the Board of all the terms exactly as stated in the agreement. *These conditions were impossible* to fulfill since the specified price exceeded the relevant PURPA/FERC ceiling and the Board was preempted from implementing that higher price in violation of the ceiling. The utility's avoided cost had dropped substantially from 1989 (when negotiations began) to 1992 (when the contract was signed). The Freehold contract had not incorporated the proper Board-approved avoided cost of the utility in 1992 in accordance with the *Smith* case. Hence, the purchase price is not sheltered from further Board action implementing the PURPA/FERC price ceiling.

## II. Respondent's Contention, That Recent Decisions of FERC Interpreting PURPA and its Regulations Are Consistent with the Third Circuit's Decision, Is Incorrect. (Opp. at 17)

An analysis of the reported decisions of FERC since the Third Circuit's decision, which Freehold cites, shows a severe conflict between FERC and the Third Circuit. The three decisions are (1) *New York State Elect. & Gas Corp.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶61,027 (1995) ("NYSEG"), (2) *West Penn Power Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶61,153 (1995) ("West Penn") and (3) *Conn. Light and Power Co.*, 71 Fed. Energy Reg. Comm'n Rep. (CCH) ¶61,034 (1995) ("CL&P"). These decisions concern the extent of state jurisdiction over implementation of PURPA/FERC's purchase rules and the invalidity of an agreement at a purchase price exceeding the PURPA/FERC ceiling. Specifically, with respect to the present case, they show that (1) the Board's approval of a price exceeding the relevant PURPA/FERC ceiling was null and that the agreement was void *ab initio* (the *CL&P* decision) and that (2) the Board had lawful jurisdiction over the agreement for the purpose of implementing that ceiling on behalf of ratepayers. (The *NYSEG* and *West Penn* decisions).

A. The *NYSEG* and *West Penn* decisions. Because of the similarity between the two cases, the discussion will focus on the more recent *West Penn* case. Previous to the FERC petition, lengthy litigation before the **state** regulatory commission and the **state** courts had determined that a valid, legally binding contract existed. (at 61,153). The gravamen of the petition was that the established rates in the long-term QF contracts should be recalculated if subsequent avoided cost calculations differ from the relevant PUPRPA/FERC avoided cost properly used to determine the original rates. As in the *NYSEG* case, FERC rejected the petition and refused to disturb the contract. (at 61,153). The FERC stated that it did not intend to adjudicate specific provisions of individual QF contracts and that

it was up to the states, not FERC, to determine the specific parameters of individual QF power purchase agreements, including the date at which a legally enforceable obligation was incurred under state law. The FERC also stated that whether the particular facts applicable to an individual QF necessitated modification of other terms and conditions of the QF's contract with the purchasing utility was a matter for the states to determine. (at 61,495). The FERC further noted that for specific QFs the choice of the critical date on which a legally enforceable obligation to deliver electricity is incurred is the responsibility of the states and not FERC and the fact that the determination was made after the date itself was immaterial. *Id.* FERC has declared that state implementation of the PURPA/FERC rules on the purchases and sales between utilities and QFs, such as adjudication of specific terms of the contracts and whether the specific facts require modification of terms and conditions, are matters for the states. Thus, the FERC, just after the Third Circuit decision and now, is clearly in conflict with the Third Circuit which applied PURPA Section 210(e) to abort state proceedings on these very matters. In conjunction with FERC's *West Penn* "hands-off" policy in favor of state determination of these matters, the Third Circuit decision, unless reversed, will work an injustice on the customers of the utility. The Third Circuit should have allowed the Board to proceed in the implementation of the PURPA/FERC price ceiling. The result of all this is that the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") will have been denied a forum and means for the implementation of the PURPA/FERC ceiling.

B. The *CL&P* decision. This important decision, issued just two days after the Third Circuit decision, supports these conclusions: **(1) PURPA mandates that a contract containing a purchase price in excess of the relevant avoided cost of the utility is void *ab initio* and (2) the treatment of such a "contract" as void *ab initio* is not inconsistent, as suggested by the Third Circuit, with the congressional pur-**

**pose of PURPA to encourage the development of cogeneration.** The FERC determined correctly, in the opinion of the Ratepayer Advocate, that the attempted implementation of a state statute, requiring a purchase price exceeding the PURPA/FERC ceiling, resulted in a "contract" which was void *ab initio*. (at 61,030). A ground for the decision was that the imposition of such a price is in conflict with the PURPA/FERC purchase price at the full avoided cost of the utility, the *maximum* allowed by Congress. (at 61,029). Therefore, the action of a state regulatory commission requiring that the purchase price exceed the relevant current PURPA/FERC avoided cost is null and the contract void *ab initio*. This FERC holding clearly contradicts the Third Circuit which held that, regardless of whether a state regulatory commission approved a purchase price at a level *per se* illegal and contrary to PURPA, that price is protected for the full term of the agreement. Consistency with PURPA and the *CL&P* decision would have required the Third Circuit to find the agreement void *ab initio*.

## III. Respondent's Contention, That the Estimates of a Large Disparity Between the Relevant PURPA/FERC Avoided Cost and the Rates to Be Paid under the Power Purchase Agreement Are Unsubstantiated, Should Be Disregarded. (Opp. at 25).

Much documentation of the disparity between the relevant Board-approved PURPA/FERC avoided cost of the utility and the purchase price in the Freehold power purchase agreement is both in evidence before the Board proceeding *sub judice* and in the record before the Third Circuit. Freehold did not, until now, raise the issue that the documents were unsubstantiated. It is especially noteworthy that, when the Ratepayer Advocate petitioned the Third Circuit to include the very important document, FCA-18, in the record, Freehold did not oppose the motion and did not make the slightest suggestion that the document was in the least unsubstantiated.

Most recently, Freehold remained silent when the Ratepayer Advocate relied on the document in its petition for reconsideration before the Third Circuit. Freehold remained completely silent until now. By an application of the authority adduced by Freehold itself, *viz., Duignan v. United States,* 274 U.S. 195, 200 (1927), Freehold should be deemed to have waived the issue.

## IV. The Disparity Between the Relevant Board-approved PURPA/FERC Avoided Cost and the Purchase Rate of the Power Purchase Agreement Is Not Only Relevant, But It Is Fundamental to the Issues in This Case. (Opp. at 19).

The disparity is relevant and fundamental to the support of the Ratepayer Advocate's case—contrary to Freehold's contention. According to the Ratepayer Advocate's **first** legal theory, since PURPA was enacted under the Interstate Commerce Clause of the U.S. Constitution, it therefore applies immediately and directly to the power purchase agreement, thus rendering null the action of the parties or any government agencies not in harmony with PURPA. The Congressional and FERC prohibition against a purchase price exceeding the utility's approved avoided cost makes any agreement in contravention of that prohibition void by virtue of the Interstate Commerce Clause. According to the **second** theory, under the law of administrative agencies, any action of a creature of PURPA (including the Board) contravening the PURPA/FERC ceiling is void as *ultra vires*. According to the **third** theory, the Board's action in approving a purchase price greater than the relevant Board-approved avoided cost of the utility violated PURPA and was preempted under the Supremacy Clause of the United States Constitution. According to the **fourth theory**, the Board had incorporated the PURPA/FERC ceiling in its own regulations, and PURPA, under §210(e)(3)(A), in the same section of PURPA upon which Freehold bases its Opposition, prohibits the Board from "exempting" QFs from its own regulations implementing the

FERC rules. Thus, PURPA preempted the Board from requiring or approving a price exceeding the PURPA/FERC price ceiling. According to the **fifth** theory, the parties agreed to have the law of New Jersey govern the agreement and that law holds directly that any contract conditioned on a price which must be approved by a regulatory agency not so empowered, as in this case, is void *ab initio. Duff v. Trenton Beverage Co.*, 4 N.J. 595, 607, 73 A.2d 578 (1950). Under any of these approaches Freehold obtained no right to have a purchase price, unlawful and in violation of public policy, perpetuated into the future.

## V. Contrary to Respondent's Contention, the Federal Courts Even Under *Bristol Energy* Did Not Have the Jurisdiction or Statutory Basis to Halt the Board from an Attempt to Implement PURPA and FERC's Rule Against Recovery of a Purchase Price Exceeding the Relevant PURPA/FERC Ceiling from the Customers of the Utility. (Opp. at 23).

Freehold contends (Opp. at 24) that the jurisdictional issue in the present case is virtually identical to that in *Bristol Energy Corp. v. N.H. Public Utils. Comm'n*, 13 F.3d 471 (1st Cir. 1994) ("Bristol Energy"). In that case, the state regulatory commission sent data requests to several QFs seeking detailed disclosures of financial and proprietary information to perform a study of wholesale power supplies required by the Energy Policy Act of 1992 ("EPAct"). (at 473). The QFs alleged that the business and financial disclosure order of the state regulatory commission violated Section 210(e) of PURPA and the FERC regulation thereunder exempting QFs from state regulation of the finances and organization of electric utilities. The court followed a two-step approach. It first recognized that PURPA placed a limitation on federal jurisdiction in proceedings involving FERC's rules dealing with the purchase and sales between electric utilities and QFs. The court held, however, that those rules were not at issue in the

case because the data requests were issued pursuant to both state law and the EPAct. (465 at footnote 5). Then the court proceeded to consider whether the PUC's limited inquiry for a study mandated by the EPAct constituted state "regulation respecting . . . [t]he financial and organizational regulation of electric utilities". (at 475). The court held that PURPA Section 210(e) did not exempt the carrying into effect by a state regulatory agency of *another* Congressional mandate not involving implementation of PURPA or FERC's rules thereunder. (at 475). The court held that an inquiry mandated by Congress did not constitute "utility type" regulation. *Id.*

Application of the *Bristol Energy* two-step approach here confirms the Ratepayer Advocate's contention. To implement (1) the prohibition against exceeding the PURPA/FERC ceiling and (2) the PURPA/FERC requirement to insure that the purchase price satisfies that prohibition, the Board should be free to limit recovery to the relevant PURPA/FERC ceiling. Furthermore, even if this were deemed not to be implementation, the statutory mandate that the rules shall insure that the purchase price does not exceed the relevant PURPA/FERC ceiling may be considered comparable to the mandate of the EPAct which *Bristol Energy* held not subject to PURPA 210(e). Thus, under either of these two scenarios a QF should not be sheltered from state regulatory action limiting recovery to the relevant PURPA/FERC avoided cost of the utility. In short, Freehold has cited not a single authority which applied PURPA Section 210(e) to foreclose a state regulatory agency from implementing the PURPA/FERC prohibition against a purchase exceeding the relevant PURPA/FERC purchase price ceiling.

## VI. Respondent's Claim That *Duignan v. United States* Bars Raising a Jurisdictional Issue on Appeal Is Incorrect. (Opp. at 28).

Freehold quotes from *Duignan v. United States,* 274 U.S. 195, 200 (1927) that "[i]t is only in *exceptional cases* coming

here from the federal courts that questions not pressed or passed upon below are reviewed." (Emphasis added). At the end of this quotation the string of authorities which the court cites makes clear that raising a jurisdictional argument always qualifies as one of "the exceptional cases" mentioned in the quotation and that such an argument may always be raised at any level of appeal.

## CONCLUSION

For the foregoing reasons and the reasons set forth in the petition, the Court should grant a writ of certiorari on the two questions presented in the petition.

Respectfully submitted,

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